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ESS WEEK
September 5

BusinessWeek

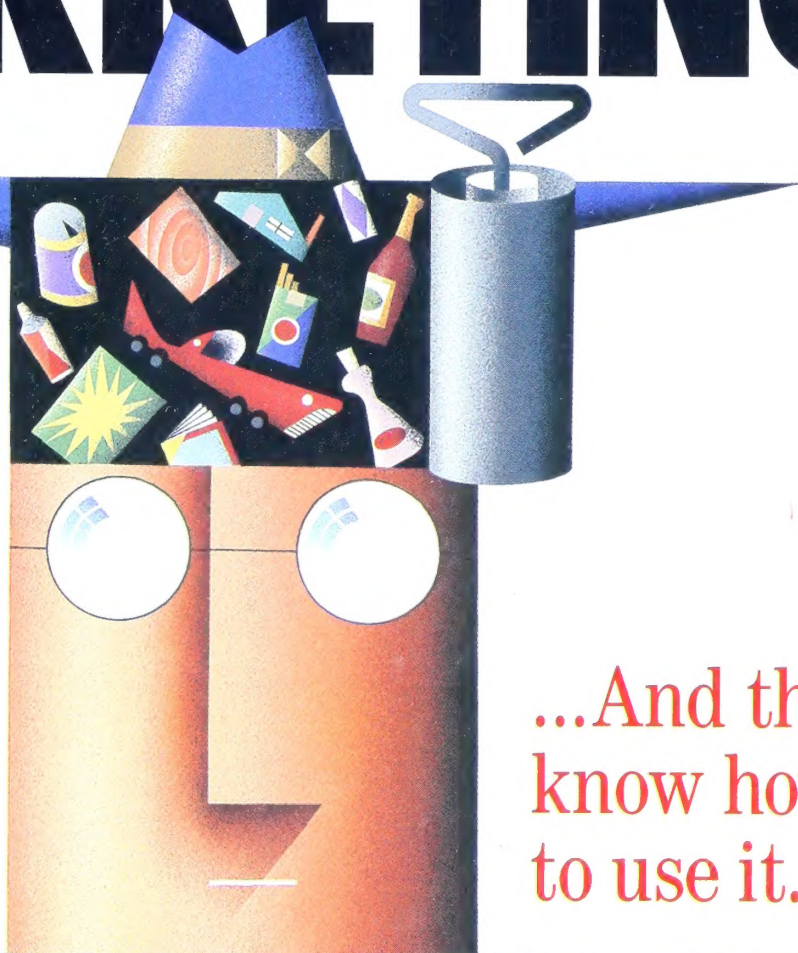
EMBER 5, 1994

A MCGRAW-HILL PUBLICATION



DATABASE MARKETING

Marketers
know more
about you
than ever
before...



...And they
know how
to use it.

PAGE 56

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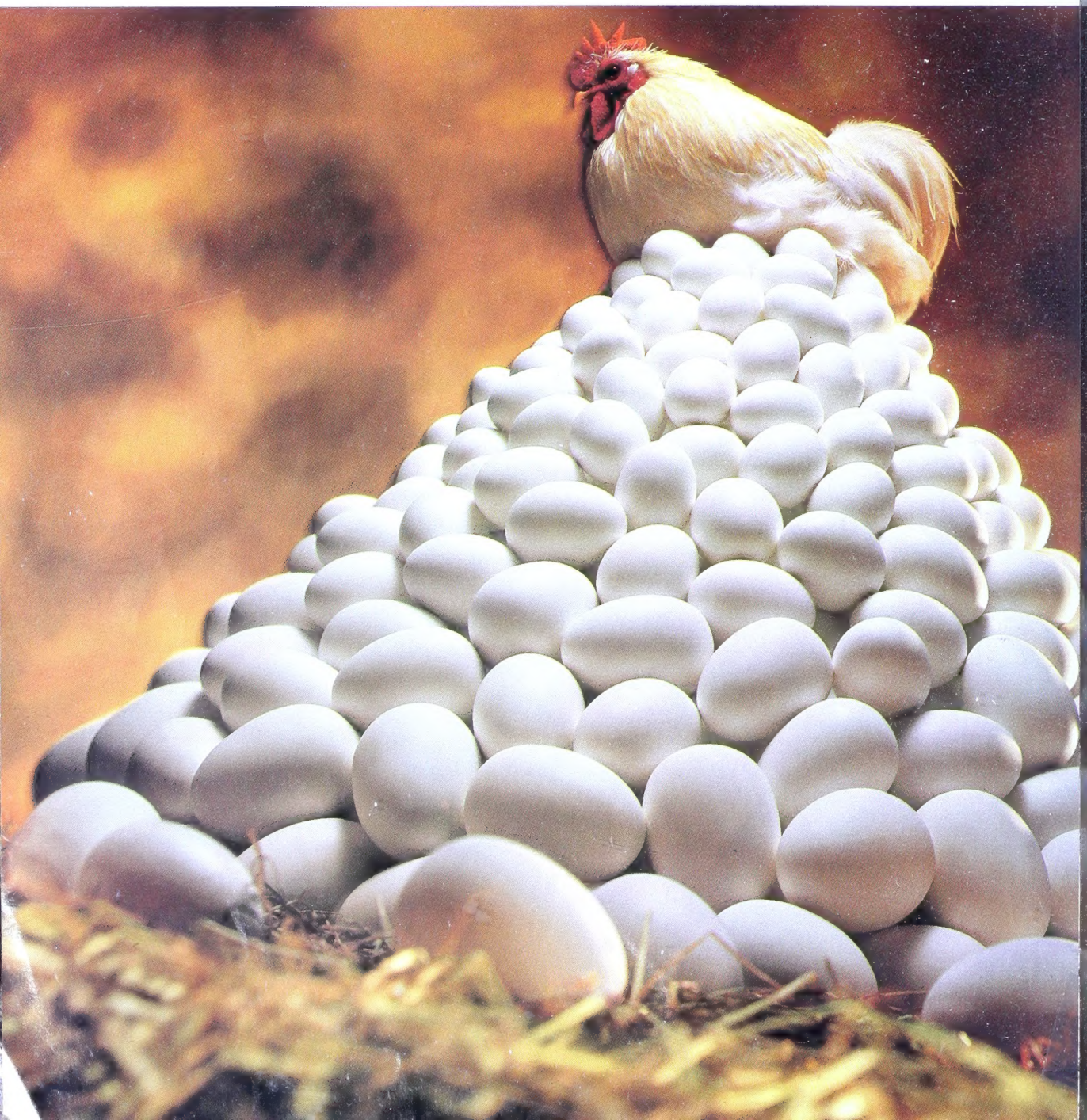
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CASINO CYBERNETICS: CLARIDGE OFFERS CUSTOM PROMOS TO ITS COMPCARD GOLD MEMBERS BY TRACKING TRANSACTIONS VIA COMPUTER

Cover Story

56 DATABASE MARKETING

From Harley-Davidson to American Express, marketers have a powerful new tool: Computers that race through mountains of customer data culled from transactions, surveys, coupons, and warranty cards. The goal: To gear promotions to hit the tiniest possible marketing niche—the individual—and simulate the old-fashioned intimacy between sellers and buyers

60 NOWHERE TO HIDE

Privacy advocates find it tough to curb marketing's intrusions

62 SIFTING FOR GOLD

New silicon and software make marketing data more manageable

Top of the News

26 NO SLOWDOWN IN SIGHT

From consulting firms to restaurant chains, the boom is far from over

28 A FAREWELL TO ARMS

Defense workers have suffered cuts, but many are finding new jobs

29 ARMS MAKERS WANT A HAND

The industry lobbies for U.S. aid

30 COMMENTARY

The crime bill is better than nothing—barely

31 BURNING UP THE MINIVAN LANE

Chrysler can't keep up with demand—and it has a hot new model on tap

34 OUT THE DOOR AT DISNEY

Katzenberg's troublesome departure

34 A DEAL THAT WOULDN'T DIE

The Viacom-Blockbuster merger

35 TOWARD A BORDERLESS PATENT

The U.S.-Japan pact is a first step

36 BACK-TO-SCHOOL HEADACHES

Teenage whims drive retailers mad

37 MBAs HIT THE ROAD

They're out to recruit recruiters

38 IN BUSINESS THIS WEEK

PC prices, SFM, Greyhound, Neutrogena, McDonald's hot coffee, Steve Wolf, the Fed's Moskow

International Business

42 MEXICO

As President, Zedillo's main challenge will be to engineer economic growth—fast

44 EUROPE

Carmakers have finally pulled out of the slump but are still facing their biggest challenge: Japan

45 THE MIDDLE EAST

Palestine: Clinton may be ready to put cash on the table, hoping to spur local development

Economic Analysis

20 ECONOMIC VIEWPOINT

Roberts: Milken's savvy should be highly rewarded, not punished

22 ECONOMIC TRENDS

Small-business optimism, consumer spending, taxing marriages, Americans work harder

23 BUSINESS OUTLOOK

World growth is revving up the U.S. export engine



2 FUTURES IMPERFECT:
THIS WAS THE YEAR MANAGERS OF
COMMODITY FUNDS—IN CORN,
SOYBEANS, AND COFFEE—SHOULD
HAVE MADE MONEY. THEY DIDN'T

Government

WASHINGTON OUTLOOK

Treasury Secretary Bentsen, an insider's insider, may be climbing back to the top of the heap

BATTLE OF THE PILLS

The FTC is eyeing the tough tactics brand-name pharmaceutical houses are using to thwart generics

The Corporation

SHERLOCK HOLMES, ACCOUNTANT

Howard Schilit has become a powerful—and some say overzealous—financial gumshoe

THE BIG SIX'S BIG SHIELD

Large accounting firms are pushing for legislation to limit investors' rights to sue for securities fraud

Legal Affairs

BIG TOBACCO'S SMOKESCREEN?

Shook Hardy, premier law firm to the politically incorrect, catches heat for its handling of study results

Finance

COMEUPPANCE IN COMMODITIES

Usually, managed funds shine when stocks are sinking—until this year, that is

THE FUND WINDFALL THAT WASN'T

As too-rosy visions fade, only the biggest banks are likely to keep offering their own family of funds



26 RUNNING FULL TILT!
CAUGHT OFF GUARD BY RED-HOT
DEMAND, COMPANIES SUCH AS NIKE
ARE SCRAMBLING TO FILL ORDERS—
WHILE PRICES BARELY STIR

75 THE GOOD LIFE AT HARTFORD LIFE

ITT's life-insurance unit has made some sharp deals and isn't done yet

76 INSIDE WALL STREET

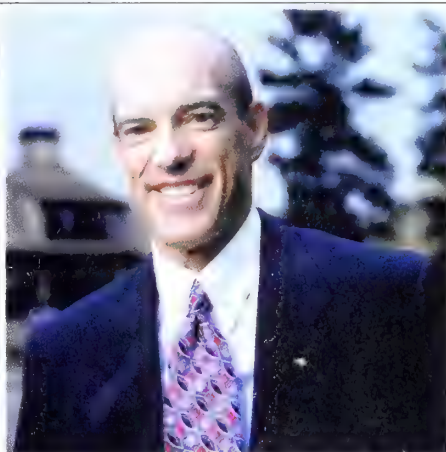
How Mirage could sweep the board
Fresh oomph at Box Energy?
Smelling gold in Vengold

97 INVESTMENT FIGURES OF THE WEEK

Media

78 MARCHING TO MORGADO'S TUNE

The new chairman is firmly in control of Warner Music—and now he's aiming at MTV



84 SPRINT PICKS UP SPEED:
CHAIRMAN WILLIAM ESREY HAS
PUMPED NEW LIFE INTO THE NO. 3
LONG-DISTANCE CARRIER BY ADDING
SERVICES AND EUROPEAN LINKS



42 HIGH HURDLES FOR ZEDILLO:
AS THE NEW PRESIDENT CONTINUES
MEXICO'S ECONOMIC MAKEOVER, HE
MUST PLACATE A PUBLIC IMPATIENT
FOR A SHARE OF THE PIE

Science & Technology

80 REAL-WORLD SUPERMATH

Nonlinear formulas let engineers with ultrafast computers revamp everything from cars to biotech

83 DEVELOPMENTS TO WATCH

"Smart" power meters, giant crystals for turbines, epilepsy sensors, photochemistry, a bug test for grain

Information Processing

18 TECHNOLOGY & YOU

Mix-and-match software for building the perfect prefab office suite

84 NO. 3—AND TRYING HARDER

Long-overlooked Sprint is positioning itself for the brave new world of telecommunications

Personal Business

88 TRAVEL: Frequent-flier deadlines

SMART MONEY: CDs that try harder

LEISURE: Fold-up bikes

Features

6 UP FRONT

10 READERS REPORT

14 BOOKS

Iritani: *An Ocean Between Us*

95 BUSINESS WEEK INDEX

96 INDEX TO COMPANIES

98 EDITORIALS

The next step for a new Mexico
Marketers know too much about us

Up Front

TALK SHOW

We run this company every day like it's never going to be sold...but if the phone rings, we'll answer it.

—Bernard Ebbers, head of LDDS Communications, to critics who say he purchased WilTel to dress up LDDS for Baby Bell buyers

EDITED BY LARRY LIGHT AND JULIE TILSNER

SPORTS BIZ

NO RUNS, NO HITS —AND NO COMMISH

Baseball owners are putting the search for a new commissioner on hold until after the strike. They want a salary cap and, without a meddling commish, stand a better chance of getting one. Commissioner Bowie Kuhn

resolved a player lockout in 1976, Peter Ueberroth settled a 1985 work stoppage, and Fay Vincent pushed to open training camps during a 1990 lockout. A big reason for Vincent's ouster, says Henry Aaron, a baseball-economics expert—not the slugger—"was to clear the deck before confrontation with the players."

Atlanta Braves Chairman William

Bartholomay, head of the owners' search committee, confirms that a commissioner will be named shortly after a player deal is done. The owners don't want to thrust the new commish into the midst of a labor dispute, he says.

Dallas-based executive-search firm Eastman & Beaudine winnowed 350 applicants down to 22. The short list now has four names, which are top secret. Possible finalists include several pols, with soon-to-retire Senate Majority Leader George Mitchell (D-Me.) the likely front-runner. While the headhunters didn't speak to him, several owners did. Mitchell lacks business expertise, but his political ties more than compensate for that. *Stephanie Anderson Forest*

GYM DANDY

THE CEO WHO THINKS HE'S ARNOLD

Macho displays are a hallmark of Lawrence Ellison of software company Oracle, a leader in the database business. His latest: outdoing professional triathlete Peter Kain in biceps. That's where you'll find yourself up and down on parallel bars. The match, at a Silicon Valley health club, took place recently as a fund-raiser for former triathlete J. McLaren, who was rendered

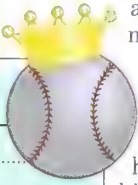


THE TOUGH GET GOING: McLaren, left, Kain, and Ellison

AND THE NEW COMMISSIONER IS...

- TOM BUTTERS** Duke University athletic director
- WILLIAM HYBL** former U.S. Olympic committee president
- PAUL G. KIRK** former Democratic National Committee chairman
- GEORGE MITCHELL** U.S. Senate Majority Leader

DATA: BUSINESS WEEK



POTOMAC FERVOR

PTA MEETINGS? PART OF A GOVERNMENT PLOT

To counter critics from the far right, the Clinton Administration is pushing "pro-family" and education initiatives, including more parental involvement in schools. Its newest foray is to urge companies to give employee-parents leeway to do that.



RILEY: Under fire

Education Secretary Richard Riley is expected to soon launch a campaign showcasing companies with innovative programs to free employees for parent-teacher meetings and volunteer work in schools. Example: NationsBank, which lets parents perform education-related activities on company time.

Even though Riley's campaign is only a public pat on the back, conservative detractors have launched a pre-emptive strike. "This is just more government encroachment" on the local control of education, grumbles Janet Parshall, spokeswoman for Concerned Women for America. What really riles Bill Clinton's foes is his plan for voluntary federal standards for math and science in classrooms. *Christina Del Valle*

REALITY CHECK

BROADER PATENT PROTECTION

would propel U.S. technology, say backers of a bill sponsored by Representative William Hughes (D-N.J.) that is headed toward a House vote. Its main aim is to tighten patent safeguards for biotechnology. Because many

biotech drugs, such as insulin, exist in nature, they are hard to patent. The Hughes bill would, among other things, grant patents to the actual drug-making process, which consists of inserting patented DNA into "host" cells that then churn out the desired drug.



IN REALITY, the bill is so broad it could cause a surge of litigation, especially in the much larger chemical industry. That's because companies with patents on chemical materials (natural products, too) could get undeserved patents on the processes for using them. One extreme possibility: A maker of acid that goes into chemicals

for plastic could sue an unsuspecting auto-parts company for patent infringement. The grounds? The plastic in the company's dashboards was made with an acid that allegedly violates the acid maker's patent. This is less of a problem for biotech outfits, which commonly control all stages of production. That's a good reason for limiting the bill to biotech. *Peter Coy*

a quadriplegic in an accident. Ellison, who prides himself on keeping in shape, with 46 repetitions, six more than Kain. True, the 180-pound Kain wore a 40-pound weight belt to roughly match Ellison's weight. But Ellison was about to turn 50 at the time of the contest, while Kain is 30.

In short, there's little sign that age is subduing Ellison's penchant for playing hard. At least the publicity-wooing stunt with Kain was less hazardous than earlier exploits.

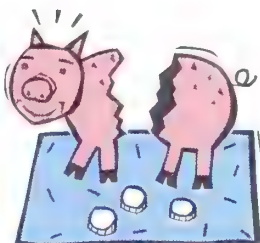
Three years ago, Ellison punctured a lung and broke his neck, shoulder, and ribs while bodysurfing during a storm in Hawaii. Two years ago, he fractured an elbow in a bicycling mishap. Next, he plans on flying a Navy F-16 jet. *Richard Branson*

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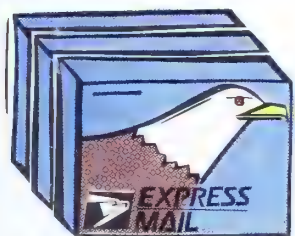
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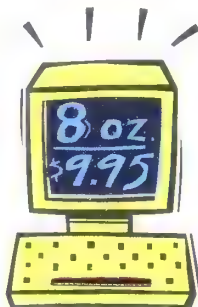
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HONCHOS

ATTENTION, KMART STOCKHOLDERS: VICTORY

Kmart CEO Joseph Antonini couldn't believe his eyes when shareholders nixed his restructuring plan at the annual meeting in June. Antonini insisted that he lost only because many shareholders abstained. By Aug. 17, though, a chastened Antonini delivered exactly what dissidents wanted: a spin-off of three specialty retailers—office supply, books, sporting goods—into independent units.

Credit his conversion to behind-the-scenes talks between shareholders and John Pound, a governance expert at Harvard University whom Anto-



CEO ANTONINI:
Has an open ear

nini hired in July. "I wanted a second opinion, to make sure that I was getting the message straight," Antonini says. Pound, who has acted as an intermediary for a few other companies, interviewed about 20 institutions that together hold more than 15% of Kmart's stock. He found no dissent: Everyone wanted separate management and boards for the units.

Antonini now says that Kmart management will talk more often with shareholders. How come? "The environment has changed, for the good. You're seeing more interaction between shareholders and management and boards. The business environment is tough, and we all have to work together to make money." Besides, Antonini isn't off the hook. Shareholders still want better performance; they've just given him more time to produce it. *Judith H. Dobrzynski*

VIRTUAL REALITY

WALTER MITTY HITS MACH II

When will virtual reality get real? Real soon, reports Magic Edge. On Aug. 27, the Mountain View (Calif.) startup, backed by Japanese entertainment giant NAMCO, will launch the most ambitious VR entertainment center yet. It features a jet fighter simulation whose

total-immersion experience outdoes rivals such as Kinney Aero and Virtual World Entertainment.

Wannabe pilots in Mountain View don a flight suit before a briefing by a squadron commander, who stays in radio contact throughout. Strapped into a pod, players "fly" through canyons and fire missiles. The pod, which pitches and

DRAWN AND QUARTERED

FIRST THE GOOD NEWS: THE RUSSKANS ARE DEFINITELY STARTING TO GET THE HANG OF CAPITALISM.



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THE FEDS

DOES TREASURY KNOW HOW TO MAKE A BUCK?

A little more than a year ago, the Treasury Dept. decided to take advantage of low interest rates by shifting the mix of federal borrowing toward shorter maturities. How has the grand experiment worked?

Not bad. It has indeed saved some money. By shifting about \$50 billion a year

from longer to shorter maturities with lower rates, the Administration saved about \$9 million last year and should save an additional \$1.7 billion this fiscal year—about 2% more than it originally predicted. And according to researchers R. H. Wrightson Associates, the strate-

FEDERAL DEBT TILTS TO SHORT-TERM

DOLLAR GROWTH IN TREASURIES, BY MATURITY, MAR. '93 TO MAR. '94

	OLD MIX*	NEW MIX
UNDER 1 YR.	3%	7%
OVER 10 YRS.	5%	4%

*How debt would have grown under previous maturity distribution

DATA: R.H. WRIGHTSON & ASSOCIATES INC

DADDY'S MONEY

If you daydream about inheriting millions, you're not alone. Baby Boomers stand to inherit an estimated \$10.4 trillion, the biggest windfall in U.S. history. But a recent poll shows that the bucks won't necessarily come easily.

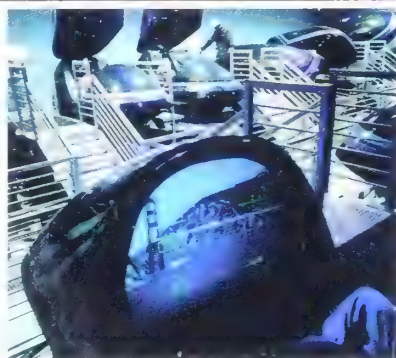
OF 500 BOOMERS POLLED:

62%	60%	21%
EXPECT TO GET AN INHERITANCE	SAY THEY DESERVE ONE	EXPECT TO FIGHT OVER IT WITH RELATIVES

DATA: FIRST INTERSTATE BANK TRUST

rolls, and the 3-D images—supplied by the Silicon Graphics computers that created *Jurassic Park's* dinosaurs—respond instantly to the joystick.

Whether that's enough to make VR a hit is unclear. "The market's very slow to take off," says consultant John Latta. Biggest problem: prices. Magic Edge, for instance, charges \$12.75 for eight minutes in the air. *Robert Hof*



MONEY MACHINE? An eight-minute simulated flight costs \$12.75

should keep yielding an additional \$1 billion to \$2 billion in annual savings through the rest of the decade.

But Wrightson's chief economist, Louis Crandall, believes the government missed an opportunity to lock in more long-term debt at last year's low rates (6.8% for 30-year bonds then, vs. 7.6% now). "They picked the absolute worst time to make the switch," he says. And if a new round of inflation causes a sharp spike in short-term rates, Treasury's move could backfire. Treasury officials say they haven't yet done the calculations to gauge the effect of the changes in the government's maturity mix. *Peter Magnusson and Dean Foushee*

FOOTNOTES

People working for temporary agencies in July, 1991: **1.5** million. In July, 1994: **2.4** million

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CAN THE U.S. TACKLE INCOME INEQUALITY?

Congratulations on "Inequality" (Cover Story, Aug. 15). You highlight an area of economic distress which, for far too long, has been ignored. The Council of Economic Advisors noted earlier this year that worsening inequality poses a "...threat to the social fabric that has long bound Americans together." It will take a staunch commitment by Congress, the Administration, and the American people to adopt policies and programs needed to rectify this gross inequality.

Amy Isaacs
National Director
Americans for Democratic Action Inc.
Washington

In 1982, having exhausted my unemployment benefits, I and a partner founded a small business. After 12 years of 70-hour weeks, we have at last risen in income level from the bottom 25% to the top 25% of Americans. Having just read your article, I can't tell you how guilty I feel now that I take an unfair share of the national income. Knowing that the only solution to this injustice is income redistribution through the tax code and already facing marginal tax rates above 50%, my wife, despite her MBA, has elected to stay home and care for our daughter—lest she take a job someone else needs more. Knowing that marginal income taxes must rise substantially to achieve a more just society, my business partner and I are re-evaluating a risky expansion that could create dozens of new jobs... but of course would only fuel our greed to make more money and would lead to further income inequality.

Stephen F. Schatz
Philadelphia

Government programs, such as the free lunch program you highlight, have tried to solve the "inequality" of students in our educational system, and it has not worked. Should not the conclusion then be that attempts to make people equal do not work? Instead, you

conclude that we need to be more active in our efforts to make people equal—the hope that the outcome seen in the past will be different in the future. Not a strong possibility.

Joel M. Bar
Agoura Hills, Ca

BECKER'S CIGARETTE-TAX NUMBERS NEED RECRUNCHING

In "Warning: A higher cigarette tax may be hazardous to health financing" (Economic Viewpoint, Aug. 1), Gary Becker claims a cigarette-tax increase is a bad idea because it will discourage too many people from smoking to raise significant revenue. He predicts that a \$1-a-pack increase would raise \$3 billion a year in new revenue. The prediction is so far outside the economic mainstream that it cannot be taken seriously.

The Congressional Joint Committee on Taxation, the Congressional Budget Office, and the Treasury Dept. all estimate that a \$1 increase would reduce smoking by about 20% and raise \$12 billion to \$13 billion in new annual revenue. These figures are confirmed by the work of 26 independent economists convened by the National Cancer Institute, as well as by Massachusetts Institute of Technology economist Jeffrey Harris.

But give Becker the benefit of the doubt. He claims that a \$1 tax increase will reduce smoking by 70%. That would mean 32 million fewer smokers in the U.S. and about 8 million premature deaths averted among Americans alive today. It would save \$35 billion a year in health-care costs, including \$15 billion paid for by the taxpayer. Wouldn't that make sound policy?

Dr. David S. Rosenthal
Director

Harvard University Health Services
Cambridge, Mass.

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it, and we deliver our services under the mark. As far as I am aware, it has not been appropriated by other consultants or corporations.

You can imagine my schizophrenic reaction of delight and chagrin on reading "making quality pay" (Cover Story, Aug. 1991), which praised a methodology and a terminology we have used extensively with our clients. If BUSINESS WEEK's representation of the ROQ message has the impact I expect, American corporations and our own company will be the winners. I am writing, nevertheless, to protect our company's asset and to set the record straight on the origin of ROQ and its process for achieving near-term business results.

John R. Murphy
President
Executive Edge Inc.
Fairfield, Conn.

FOR ISSUES DON'T AFFECT CALPERS' INVESTMENTS

In contrast to a reader's letter ("Will unions use proxy battles just for better bargaining?" Readers Report, Aug. 1991), the California Public Employees' Retirement System is not making investment decisions based in any part on whether companies support their employees in any particular manner. CalPERS is looking at workplace practices—among many other issues—to determine whether they have any relationship to corporate performance.

Every year, CalPERS reviews its stock portfolio and compares each holding's performance against that of its peers. We arrive at a list of 10 companies that will be the focus of our corporate governance activities. Beginning this fall, the issue we will look at as potentially relating to poor performance is workplace practices. We have no plans to become involved in labor grievances.

Richard H. Koppes
Interim Chief Executive Officer
CalPERS
Sacramento

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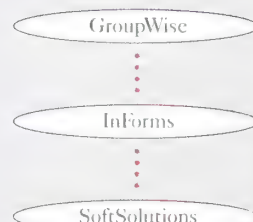
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AN OCEAN BETWEEN US: THE CHANGING RELATIONSHIP OF JAPAN AND THE UNITED STATES, TOLD IN FOUR STORIES FROM THE LIFE OF AN AMERICAN TOWN

By Evelyn Iritani

Morrow • 272pp • \$23

LOVE AND FEAR OF JAPAN IN ANYTOWN, U.S.A.

Port Angeles, Wash., seems an unlikely setting for a book about relations between Americans and Japanese. Although perched on the Pacific Rim, it is an isolated blue-collar town, a strip of gas stations and fast-food joints on the Olympic Peninsula, 65 miles northwest of Seattle, overshadowed by two big pulp-and-paper mills. It has no Japanese experts, no international trade offices, not even a golf resort to attract Japanese tourists.

But on another level it's perfect. In 1988, when one of its mills was acquired by Japan's Daishowa Paper Manufacturing Co., the town's 17,000 residents had to face their resentments and fears about the growing power of a nation many had fought in World War II. Most had stopped thinking about Japan since the bad days when they had to keep lights off at night for fear of a Japanese air attack. Now, a Japanese company was one of the town's biggest employers.

That awkward transition is what attracted Evelyn Iritani, a reporter with the *Seattle Post-Intelligencer*. But Iritani found this Anytown, USA, had ties with Japan that extended back much further than she could have guessed. The personal tales, the friendships, the ambiguities, the humor, and the sorrows she turned up went much deeper than the superficial culture clashes you might expect.

In *An Ocean Between Us*, formal relations between the two nations are but a backdrop to four fascinating tales of personal encounters between East and West, well told and well worth telling. Like all good storytellers, Iritani builds suspense and tosses in elements of the unexpected. Drawing on scores of interviews on both sides of the Pacific, she weaves a wealth of remembrances into vivid portraits. Her memorable characters include an American accused of spying in Japan, a restaurant owner suspicious of Japan but fond of his Japanese American boyhood

friend, a Japanese manager who reluctantly moves to the U.S. but embraces the American way of life, and a woman mourning a sister lost in a bizarre wartime attack.

Surprisingly, the first story begins in 1834. A Japanese ship, blown off course by trade winds, sank near the coast of the Olympic Peninsula. Most on board died, but the Makah Indians rescued three young sailors and made them slaves. Nearly 160 years later, one of their direct descendants, Masao Ya-

were interned behind barbed wire. Rumors circulated that his father, who had returned to Japan, was a spy.

Elsye Mitchell, another child of Port Angeles, met a worse fate during the war. After marrying and moving to Oregon, she was one of six Americans on a church outing killed by a Japanese balloon bomb that had floated across the ocean. In an interesting counterpoint, Iritani also explores the lives of the Japanese schoolgirls drafted by the government to make those bombs.

The book's final story, though, is told from the perspective of one most Americans will relate to best: Dave Hoglund, a paper-mill worker, who sure he'd lose his union contract after a job when Daishowa bought his mill. "That's how it always happens," he thought. Instead, Daishowa invested \$560 million to modernize the mill, and Hoglund was one of four workers sent to Japan to learn the Daishowa way. But he was not to convert to Japanese manufacturing processes.

Iritani insisted the American way is best—and was promoted anyway. In a final irony, financially strapped Daishowa decided to shut down 10 paper-making machines and impose huge layoffs in Fuji City, Japan—and keep the Port Angeles mill humming.

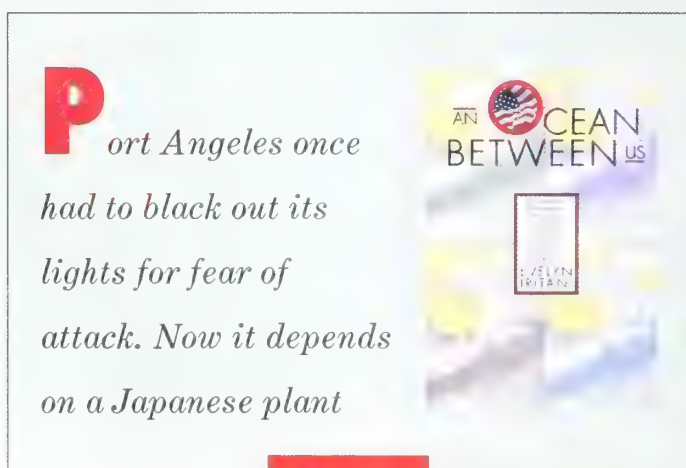
Iritani is well-suited to grasp both sides of the U.S.-Japan equation. Her father is a second-generation Japanese American from a Colorado farm family; her mother was born and raised in Japan. Her book, full of irony and twists of fate, shows the

complexity of U.S.-Japan relations. "Paper-mill workers whose jobs have been saved by a company from Japan," she writes, "stand in the grocery-store line next to unemployed lumber-mill workers" who blame raw log exports to Japan for eliminating sawmill jobs.

"Port Angeles and Daishowa need each other. The United States and Japan need each other," Iritani concludes. Global trends have forced the people of Port Angeles—and all Americans—to change the way they think about Japan and the Japanese in their midst. The need to look beyond rhetoric to get to know their Pacific neighbors. By conveying the complicated human side of the relationship, Iritani shows the way.

BY DORI JONES YAN

Seattle Bureau Chief Yang has covered U.S.-Asian relations from both sides of the Pacific.



mamoto, a feisty, high-velocity man, insists on reciting a Buddhist prayer on the beach and bowing in gratitude to one of the few remaining Makahs, who now export logs and seafood to Japan. "A Japanese man travels thousands of miles to thank the people who rescued his ancestors.... The people who enslaved his ancestors are now economically beholden to the descendants of the people they once enslaved. Who is thanking whom? And for what?" Iritani muses.

The story of Tom Osasa, son of the first Japanese family to settle in Port Angeles, starts out all-American. Growing up in the 1930s, he was part of his high school's in-crowd, playing cards, shooting hoops, dancing to big-band music. Born in the U.S., he seldom felt foreign. But when the war broke out, he and his family, like thousands of other Japanese Americans on the West Coast,

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custody \küs-tə-dē\ *n* [ME *custodie*, fr. L *custodia* guard-
ing, fr. *custod-*, *custos* guardian] : immediate charge and control
exercised by a person or an authority (as over a ward or a suspect)
: SAFEKEEPING

custom \küs-təm\ *n* [ME *custume*, fr. OF, fr. L *consuetudo*,
consuetudo, fr. *consuetus*, pp. of *consuere* to accustom, fr. *com-*
sumere to accustom: akin to *sum* one's own—more at *summe*]
1 *a* : a usage or practice common to many or to a particular place
or class or habitual with an individual *b* : long-established prac-
tice considered as unwritten law *c* : repeated practice *d* : the
whole body of usages, practices, or conventions that regulate social
life *2 pl* *a* : duties, tolls, or imposts imposed by the sovereign
law of a country on imports or exports *b* *usu* *ing* in *comstr* : the
agency, establishment, or procedure for collecting such customs *3*
a : business patronage *b* : *usu* habitual patrons : CUSTOMERS
syn see HABIT

custom *adj* 1 : made or performed according to personal order
2 : specializing in custom work or operation <a ~ tailor>
cus-tom-ary \küs-tə-mə-ē\ *adj* 1 : based on or established by
custom 2 : commonly practiced, used, or observed *syn* see
USUAL *and* occasional—**cus-tom-ari-ly** \küs-tə-mə-ē-lē\ *adv*—
cus-tom-ari-ness \küs-tə-mə-ē-nəs\ *n*
cus-tom-built \küs-təm-bilt\ *adj* : built to individual specifica-
tions
cus-tom-er \küs-tə-mər\ *n* [ME *customer*, fr. *custume*] 1 *a* : one
that purchases *usu* systematically or frequently a commodity or
service *b* : one that

cus-tom-er-ize \küs-tə-mə-rī-zē\ *vt* 1: to make a com-
pany more responsive to its customers and better able
to attract new ones 2: to customerize an organization's
information strategy, e.g., to extend systems capabilities
to field locations and other points of customer contact
and support 3: what Unisys Corporation does for a
growing roster of companies, and government agencies,
worldwide *syn* see CUSTOMER SERVICE, COMPETITIVE
EDGE, BUSINESS-CRITICAL SOLUTIONS, REVENUE GENERATION

cus-tom-made \küs-təm-(m)ād\ *adj* : made to individual speci-
fications
cus-tom-tail-ored \küs-təm-tā-lər\ *vt* : to alter, plan, or build according to
individual specifications or needs

cut \kət\ *vb* **cut**; **cut-ting** [ME *cuten*] *vt* 1 *a* : to penetrate
with or as if with an edged instrument *b* : to hurt the feelings of
a : to strike sharply with a cutting effect *d* : to strike (a ball) with
a glancing blow that imparts a reverse spin *e* : to experience the
growth of (a tooth) through the gum 2 *a* : TRIM, PARE <~ one's
nails> *b* : to shorten by omissions *c* : DISSOLVE, DILUTE, ADULTER-
ATE *d* : to reduce in amount <~ costs> 3 *a* : MOW, REAP <~ hay>
b (1) : to divide into parts with an edged tool <~ bread> (2)
: FELL, HEW <~ timber> *c* : to separate from an organization : DE-
TACH *d* : to change the direction of sharply *e* : to go or pass
around or about 4 *a* : to divide into segments *b* : INTERSECT,
CROSS *c* : BREAK, INTERRUPT <~ our supply lines> *d* (1) : to
divide (a deck of cards) into two portions (2) : to draw (a card)
from the deck *e* : to divide into shares : SPLIT 5 *a* : STOP, CEASE
<~ the nonsense> *b* : to refuse to recognize (an acquaintance)
: OSTRACIZE *c* : to absent oneself from (as a class) *d* : to stop (a
motor) by opening a switch *e* : to terminate the filming of (a
miniature scene) *f* : to make by or as if by cutting, as
a diamond

cut *n* 1 *a* : a sharp or shallow notch or groove cut in a surface
: RINGRAVE (4) : to shear or nonow (a hair) *e* : to type on a

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EDITED BY STEPHEN H. WILDSTROM

MIX 'N' MATCH MAKES SUITE DEALS SWEETER

Microsoft Office, the top-selling computer software suite (including word processing, spreadsheet, and graphics programs in a single, heavily discounted package), comes on 29 floppy disks. On a CD-ROM, there would be room for all the disks, and 500 megabytes—enough for a reference library—left over. Small wonder that as CD-ROMs have increasingly become standard on new computers, software publishers are trying to figure out just what to do with all that space.

WordPerfect Corp. has an

WordPerfect and templates for the Quattro Pro spreadsheet. After selecting components, buyers can fill out an on-line order form and then receive authorization "keys" to install the software. "It's about giving customers choice," says WordPerfect suite-marketing director Scott E. Nelson. "Our market research shows that users want the flexibility to build their own suites."

Many details of the arrangement remain to be worked out. WordPerfect plans to distribute Select through existing sales chan-

far cheaper than floppies. Furthermore, printed documentation costs even more than disks and often ends up unused. WordPerfect plans to make the printed manuals an extra-cost option with Select, and most customers are expected to rely on enhanced on-line help files.

Still, competitors are skeptical of WordPerfect's plans. "Third-party distributors have tried this, and they haven't met a lot of success," says Paul McNulty, director of desktop product marketing for Lotus Development Corp. He predicts that WordPerfect will encounter problems with billing and order fulfillment. Still, Lotus isn't fighting the concept of distributing programs on CD-ROM and will make its new SmartSuite 3.0 available on CD-ROM. It will also offer a multimedia sampler, catalog, and test-drive disk called Lotus Gallery.

Robbie Bach, Microsoft Office group product manager, worries that including third-party software on a CD-ROM will make it difficult for publishers to maintain the consistency of their office suites. But, he says, Microsoft Corp. is considering how it might make an approach such as PerfectOffice Select work. Meanwhile, it, too, is making its suite available on CD.

The market for suites continues to heat up. A discounting scheme in which the customer gets three or more programs for the price of two, suites now account for 50% of spreadsheet, word processing, and graphics software sales. PerfectOffice is the first fruit of Novell's acquisition of WordPerfect and Quattro Pro, giving it a wide-ranging suite to compete with Lotus and Microsoft. Lotus is shipping the latest SmartSuite this summer and Microsoft has new editions of Office for Windows, Macintosh, and the new Power Mac coming this fall. But if WordPerfect's mix-and-match CD catches on, these prefab suites could be nearing the end of the line.

S. W.

ROLL YOUR OWN SOFTWARE SUITE

Major components of PerfectOffice Select

Product/Function

WORDPERFECT Word processor

QUATTRO PRO Spreadsheet

PRESENTATIONS Presentation graphics

INFOCENTRAL Personal information manager

ENVOY Document exchange

GROUPWISE E-mail



BUYERS CAN ORDER ON-LINE

PARADOX Database management

VISUAL APPBUILDER Programming language

DATA: WORDPERFECT/NOVELL APPLICATIONS GROUP

idea—one designed both to propel the Novell Inc. unit into the suite business and to overhaul the way office software is marketed. PerfectOffice Professional, which is scheduled to ship in the fourth quarter, will take up perhaps 40 floppy disks. Then, about six weeks later, the company plans to release a version on one CD.

PerfectOffice Select will have the eight major components of PerfectOffice Professional plus a variety of third-party products, such as specialized dictionaries for

nels, and different users may see different packages. Corporate buyers might get the CD-ROM free and pay for copies of each program they order. For a single price—not yet set—an individual might get a choice of any three major applications on the disk.

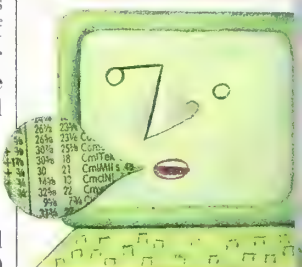
Distributing software on CD is irresistible—for consumers and manufacturers. Installing from a single disk might help prevent repetitive stress injury from swapping all those floppies. And a CD-ROM costs only a bit more than \$1 to produce in large quantities—

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SUBNOTEBOOKS

AST'S BIG-SCREEN BABY

Subnotebook computers are continuing to nip at the heels of their bigger laptop brethren. AST Research Inc. is the latest to break into the under 5-lb. field with its new Ascendia 500. With a 9.5-in. passive-matrix color display, weighs 4.5 pounds and starts at \$2,299.

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MIKE MILKEN FOR TREASURY SECRETARY

BY PAUL CRAIG ROBERTS



Junk bonds gave many of America's hottest companies the money they needed to grow. In return for his contribution, Milken was vilified and jailed. He deserves more than an apology.

At the beginning of this year, *The Wall Street Journal* reported that the "junk-bond market had another record year in 1993." The story went on to say that "last year's \$68 billion-plus total is nearly twice 1992's record issuance—and equal to the total raised from 1982 through 1986," the years spanning the apex of Michael R. Milken's career.

I have been waiting patiently for the cries of alarm, but, alas, no James B. (*Den of Thieves*) Stewart has risen to decry the growth of "the greatest criminal conspiracy the financial world has ever known." No Benjamin (*License to Steal*) Stein has appeared to explain the durability of this "Ponzi scheme." No Connie (*The Predators' Ball*) Bruck is scorning junk-bond financiers as the "Cosa Nostra of the securities world." Treasury Secretaries are not speaking of "junk bondage."

As P.T. Barnum said, a sucker is born every minute. In the late 1980s, the whole country was suckered by a shrill and largely uninformed campaign against junk bonds and their progenitor, Michael Milken. But that song won't play again. The Salomon Brothers Inc. high-yield index has increased by 63% since 1990, and junk-bond underwriters, such as Merrill Lynch, Morgan Stanley, Salomon, and Goldman Sachs, earned \$1.18 billion in fees last year from their junk-bond operations. The *Journal* noted on July 25 that even staid "Chase Manhattan Bank is trying to muscle into the junk-bond market."

This is a lot of financial prestige to be perpetuating a Ponzi scheme. Indeed, there are now more than 70 mutual funds offering junk bonds, backed by such respected names as Merrill Lynch, Value Line, Fidelity Investments, T. Rowe Price, Morgan Stanley, Paine-Webber, Prudential Securities, and Dean Witter Reynolds.

BIG OBSTACLE. How soon we forget. In 1991, when Milken was frog-marched off to jail, junk bonds were almost universally seen as Satan's tools for grinding the little people under by overloading their employers with unserviceable debt. Job losses that were part of the necessary restructuring to make our companies competitive were blamed on Milken's greed—although it was investment-grade companies that were shedding employees, while the junk-financed companies were growing rapidly.

Milken's companies are known for their successes, not their failures. Among the many that Milken's junk bonds helped to launch into the big time are MCI, McCaw Cellular, TCI, Viacom, Turner Broadcasting, Time Warner, Stone Container, and Medco.

MCI Communications Corp. founder William G. McGowan said his biggest obstacle launching MCI was the unavailability of capital. McGowan wrote: "The heart of the problem was that banks and institutional investors do not know how to finance growth companies. But Milken did, and MCI went from a struggling company worth several hundred million dollars to a \$16.8 billion giant employing 36,000 people." Another company whose potential Milken recognized—a judgment recently vetted by the Federal Reserve—was AT&T when it purchased this Milken junk company for \$12.6 billion. Tele-Communications Inc., now worth over \$10 billion, and Viacom Inc., worth \$5.6 billion, are other Milken junk companies.

When people want to see the news as it happens, they turn to Turner Broadcasting System Inc.'s CNN. Milken raised \$1.4 billion for the company, taking it from a \$373 million outfit to a multibillion-dollar giant contemplating buying out CBS Inc. Should you send an overnight letter via Federal Express or order a Domino's pizza, you will use a package envisioned and manufactured by Stone Container Corp.

Barnes & Noble, the world's largest bookstore; Hasbro, the nation's biggest toy maker; Safeway Stores, the huge grocery chain; J.E. Eagle and its parent, Chrysler—all receive critical financing from the junk-bond king. Medco Containment Services Inc., the pharmaceutical company that distributes mail-order drug prescriptions for 1,000 benefit plans covering 33 million people, was worth \$35 million when Milken began raising capital for it. In November, 1993, Merck & Co. paid \$6.2 billion for the company.

The campaign against Milken culminated in Rudolph W. Giuliani's 98-count indictment, a media event that he dared not take to trial. Milken was bludgeoned with the Racketeer-Influenced & Corrupt Organizations Act and prosecutorial threats against members of his family into coming up with six counts against himself, which he entered as a plea. He was then double-crossed and given an unprecedented jail term for offenses more trivial than the Social Security tax fraud committed by his sentencing judge, Kimba M. Wood, who scuppered her as Clinton's Attorney General.

President Clinton should give Milken a pardon, a public apology for his frame-up by U.S. attorneys, grant full restitution for the tortured fines, and appoint him Treasury Secretary. Milken would bring to the Treasury not only the missing financial skills but also the missing veracity. His presence would elevate the moral tone of the entire Administration.

PAUL CRAIG ROBERTS IS JOHN M. OLIN FELLOW OF THE INSTITUTE FOR POLITICAL ECONOMY AND DISTINGUISHED FELLOW OF THE CATO INSTITUTE IN WASHINGTON, D.C.



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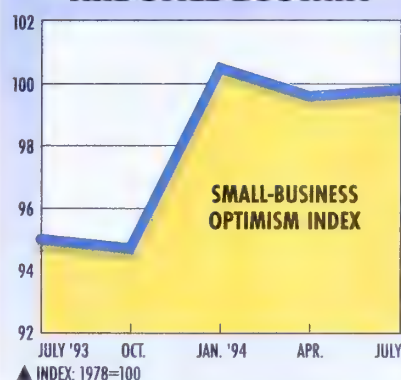
BY GENE KORETZ

U.S. SMALL BUSINESSES SEE ONLY ONE DARK CLOUD: WASHINGTON

Economic growth may be slowing, but America's small businesses—which are acutely sensitive to the economy's perturbations—have yet to register this development. According to the latest quarterly survey by the National Federation of Independent Business, conducted in July, its small-business optimism index remains in bullish territory (chart).

NFIB economist William C. Dunkelberg notes that 15% of respondents thought the next three months a good time to expand, compared with just 9% in July, 1993. And those anticipating higher sales outweigh those expecting declines by 19 percentage points.

SMALL-BUSINESS SPIRITS ARE STILL BUOYANT



DATA: NATIONAL FEDERATION OF INDEPENDENT BUSINESS

On the inventory front, satisfaction with stock levels "remains about as favorable as it has ever been in spite of accumulation in the second quarter," says Dunkelberg. Plans to add to inventories are also strengthening.

Meanwhile, capital spending is still on a roll, with some 66% of companies reporting capital outlays during the past six months, the highest tally since the 1970s. And rising hiring plans, worker compensation, and job vacancies indicate that small business is facing "the tightest labor market in years."

As for credit conditions, the survey occurred before the Federal Reserve's latest interest-rate hike. But Dunkelberg doubts that the hike upset most companies very much. So far this year, he says, "small businesses seem to have taken the steady rise in rates in stride."

If there's a fly in the ointment, aside

from chronic concern over taxes and regulation, it's the political climate. Only 4% of respondents rated the President's policies as "good" or "excellent," and just 1% accorded such favorable grades to Congress. Indeed, a third of those leery about expanding their businesses cited the political climate as the major reason.

USING MORE PLASTIC MAY NOT MEAN BUYING MORE GOODS

Don't assume that the recent surge in consumer installment debt signals stronger consumption ahead. For one thing, says economist Mark M. Zandi of Regional Financial Associates Inc., part of the pickup simply reflects rising substitution of credit cards for cash and checks. Both businesses and individuals, he notes, are making greater use of credit cards for a wide variety of purchases. Although they pay their card bills on time and thus aren't really borrowing, the level of installment debt outstanding rises.

At the same time, Zandi notes that installment credit has waxed and waned with the mortgage refinancing boom. When refinancing was in high gear in 1992 and 1993, the share of retail sales financed by installment debt declined as many households restructured their mortgage payments and then used the extra cash, in part, to buy goods. "With the collapse in refi activity earlier this year," he says, "consumers are turning to installment borrowing again to finance their purchases." One source of funds has simply replaced another.

MARRIAGE IS BECOMING A BIT MORE TAXING

How much did America's 1993 tax law, which raised taxes on high-wage earners and boosted credits for working families, affect married couples? For most couples, not very much. But for some, a lot, report Daniel R. Feenberg and Harvey S. Rosen in a National Bureau of Economic Research study.

As in the past, many married couples with roughly equal individual incomes pay more taxes than they would if they were unmarried. And many married couples with unequal incomes receive a "subsidy" via a reduced tax bite. But while the old law was modestly pro-marriage in the sense that married couples on average received a small tax break, the new

law is modestly antimarriage. The study projects that 52% of couples will pay a average marriage tax of \$1,244 this year compared with 38% receiving an average subsidy of \$1,399.

Married couples with incomes above \$200,000 a year will be hit hard, however. Under the old law, 66% would have paid an average marriage tax of \$3,666 while 34% would have received a health average subsidy of \$18,241. Instead, 86% will pony up an average \$9,990 this year and 12% will receive an average subsidy of \$9,197.

Ironically, for some poorer working couples, who receive tax credits in the form of cash, splitting up could really pay off. The study estimates that a couple with each spouse earning \$10,000 apiece and two kids could boost the income by \$3,700 by divorcing and setting up separate households.

WHY AMERICANS WORK LONGER HOURS THAN GERMANS

Here's a puzzle: Two decades ago the U.S. led the world in reducing work hours. Americans worked fewer hours than West Germans and other Europeans and seemed more devoted to leisure. Today, the situation is reversed. American workers now put in about 15 more hours than Germans, who enjoy more leisure than European neighbors.

Furthermore, note economists Linda Bell of Haverford College and Richard Freeman of Harvard University in a new study, this shift is reflected in worker attitudes. In the 1960s, many German workers would have liked to increase their work time. Today, however, they are more interested in working less, while Americans are interested in working even longer hours.

One reason for this may be that high German taxes and social benefits make work less rewarding. But Bell and Freeman note that taxes and benefits are high in other European nations, where people still work more than Germans. Their analysis indicates that workers work longer hours in countries with a relatively wide gap between earnings than they do in countries like Germany with low earnings inequality.

Thus, the two economists believe that greater earnings inequality in the U.S., combined with less job security and a lower safety net, has heightened incentives for work. In America, says Freeman, "low-wage earners have to really scramble to survive, while high-wage earners can wind up with a pot of gold."

WORLD GROWTH IS REVVING UP THE U.S. EXPORT ENGINE

Germany is in recovery—finally. Elsewhere in Europe, businesses and consumers are stepping to a more confident beat. Japan's economy may be limping out. And the newly industrializing nations are surging ahead. In the U.S., the pleasing strains of world growth are music to exporters' ears.

In fact, with global growth in sync and on the rise, it may be that U.S. exporters in 1994 will enjoy their best year since 1988. Of course, because of increased imports, foreign trade still exerts quite a downward tug on the U.S. economy. In the first half alone, it subtracted more than two percentage points from economic growth.

Moreover, the foreign trade sector showed little improvement in June. The trade deficit for all goods and services hardly changed, at \$9.4 billion, from \$9.5 billion in May. Likewise for goods alone, the deficit stood at \$14.2 billion compared with \$14.3 billion. Merchandise exports rose 4.2% in June, a bit faster than the 3% advance in imports.

However, the trouble with exports is America's voracious appetite for imports—from Japanese semiconductors to Tuscan ceramics. So far this year, imports are growing at an astounding 25.9% annual pace, five times the 5.2% pace of exports. The overall market share grabbed by nonoil imported goods jumped to nearly 26% in the second quarter (chart). Since the recovery began in 1991, that share has risen rapidly after barely growing in the late 1980s.

RETAIL STOCKPILES MAY CURB IMPORTS

While reversing the trade imbalance may seem insurmountable, some recent developments suggest that the trade deficit will not be nearly as big a hindrance to U.S. domestic product growth in the second half as it was in the first. One reason is that slower domestic demand, especially consumer spending, should curb the onslaught of imports into the U.S. That may already have happened in the second quarter, when the downshift in spending caused a buildup of wholesale and retail trade inventories. Many of those warehoused goods came from abroad. To get down their stockpiles, retailers will be ordering—not only from domestic manufacturers but from foreign suppliers as well.

The most recent sign that U.S. manufacturing is losing momentum is a sharp 4.2% drop in July durable goods orders, the largest in 2½ years. Seasonal shutdowns in the auto industry and a drop in aircraft orders exaggerated the decline, but the weakness was widespread. Even if August bookings recoup all of the July loss, which is unlikely, third-quarter orders will still be below the second-quarter level.

One area of imports that isn't likely to slow much, though, is capital goods. A beneficiary of the U.S. boom in business investment, imports of capital goods are up 18% from a year ago. And with spending plans still flush for the rest of the year, foreign producers of heavy equipment and high-tech goods should continue to do well.

OPTIMISM IS PICKING UP AROUND THE WORLD

But at the same time, U.S. exporters will be busier, as renewed demand from a stronger Europe boosts their production schedules. Although Britain—America's biggest European customer—has been in recovery for some time now, the Continent was roiled by the recession in Germany. Now, however, all signs point to an upturn in Europe's biggest economy, paving the way for growth throughout the region.

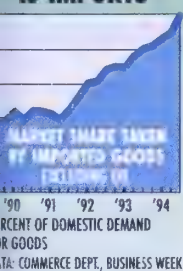
Worldwide business optimism is clearly on the rise, says Dun & Bradstreet Corp.'s latest survey of more than 11,000 executives in 16 countries, with increasingly upbeat assessments for third-quarter sales, profits, and employment. Europe led the increase in confidence, following an even greater gain in the previous quarter, which was the largest jump since D&B began the survey in 1988.

Healthier demand from across the Atlantic is already translating into faster-growing sales of U.S. goods. New demand from Europe is a big reason for the acceleration. After tumbling for two years, exports to Western Europe have bounced back strongly since February (chart).

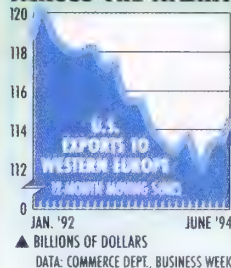
In better times, Europe purchased 25% of U.S. exports. Today, that share has slipped to 20%. Bringing the ratio back to prerecession levels could mean an additional \$24 billion in exports in 1995. That's two percentage points on economic growth, although rising imports could offset that.

Across the Pacific, the news is not as optimistic. Trade

TRADE PROBLEM IS IMPORTS

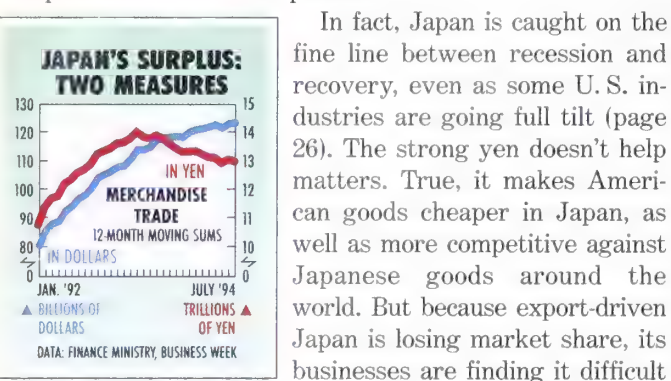


MORE GOODS HEAD ACROSS THE ATLANTIC



Business Outlook

talks between Japan and the U.S. have all the equanimity of the Major League Baseball talks, as the Sept. 30 deadline set by the U.S. for negotiations aimed at getting the Japanese government to buy more American goods draws near. In addition, the different near-term growth prospects between the two countries will not help to smooth out the problem.



to launch a recovery there. And even with dismantled trade barriers, economic growth will remain the key to improving the bilateral trade balance.

In June, the U.S. trade deficit with Japan rose to \$5.5 billion from \$4.4 billion in May. And according to Japan's Finance Ministry, the deficit widened again in July, to \$5.6 billion, the second-biggest gap on record. Since 1991, the U.S.-Japan trade deficit has swollen by 75.7%.

EXPORTS TO JAPAN ARE UP 7.8% THIS YEAR Is the U.S. at such a trade disadvantage with Japan? Not really. The data are exaggerated by the sharp weakening of the dollar against the yen. While the dollar-denominated trade deficit was widening during the past three years, the dollar itself was dropping by 34%, pushing up the value of U.S. imports and reducing the export tally.

The strong yen is hammering Japan's economy. Sure, in dollar terms, the Japanese surplus is still growing. But in

yen terms, the surplus peaked in early 1993 and has been falling ever since, dragging down economic growth (chart).

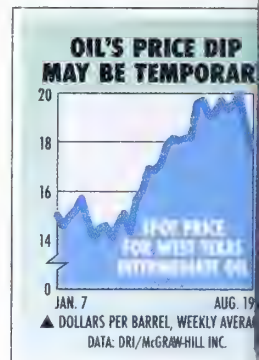
In fact, because of the price advantage, American goods in Japan are doing quite well. U.S. exports there have increased a respectable 7.8% so far this year. But just as with other countries, the trade problem rests on American imports from Japan—up 10.6% in the first half.

But even as U.S. purchases of consumer goods taper off, the total import bill may not fall by much. For one thing, the U.S. and many other countries will face higher fuel costs. The energy tab will look bigger if, as expected, crude-oil prices bounce back from their August dip.

Oil prices have picked up since March. OPEC is finally sticking to its production agreements, and political turmoil in Nigeria raises supply worries. From March until early August, the spot price for crude oil jumped 41.8%, to about \$20 per barrel (chart). It has fallen \$2 since then for seasonal reasons: a rise in North Sea production and a drop-off in demand from refineries, some of which are closed for yearly maintenance.

Prices probably won't stay down, though. With winter coming on and better growth worldwide, fuel demand will pick up. By the fourth quarter, world demand for crude is expected to outstrip supply by more than 2 million barrels per day, estimates the International Energy Agency.

But even as better world growth lifts America's energy bill, it will also grease the country's export machine. In fact, after years of cost-cutting and productivity enhancements, the coming year will be a time that U.S. manufacturers will relish. And at the same time, trade will shift from being a drag on economic growth to providing a lift that will help to keep the expansion rolling along.



THE WEEK AHEAD

PERSONAL INCOME

Monday, Aug. 29, 8:30 a.m.

Personal income in July rose 0.5%, according to a survey of economists by MMS International, following a 0.1% gain in June. Consumer spending is expected to be up 0.3%, after a 0.4% rise.

NEW SINGLE-FAMILY HOME SALES

Tuesday, Aug. 30, 10 a.m.

July sales should fall to a 610,000 annual rate, from 641,000 in June.

CONSUMER CONFIDENCE

Tuesday, Aug. 30, 10 a.m.

The Conference Board's index probably rose to 92 in August, from 91.6 in July.

LEADING INDICATORS

Wednesday, Aug. 31, 8:30 a.m.

The July leading index should rise 0.1%, led by materials prices and building permits. The June index was up 0.2%.

FACTORY INVENTORIES

Wednesday, Aug. 31, 10 a.m.

July inventories likely increased by 0.3%, after June's 0.1% rise. Consumer-goods output has outpaced demand.

NAPM SURVEY

Thursday, Sept. 1, 10 a.m.

The National Association of Purchasing Management's index should slip to 57.5% in August, from 57.8% in July.

CONSTRUCTION SPENDING

Thursday, Sept. 1, 10 a.m.

Construction outlays probably rose 0.1% in July, after growing 0.2% in June. Spending is likely to slow in the second half, given the recent weakness in new construction contracts.

EMPLOYMENT

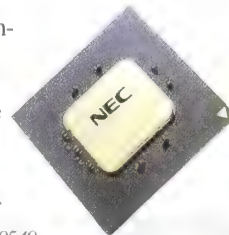
Friday, Sept. 2, 8:30 a.m.

August nonfarm payrolls are expected to show an increase of 225,000 workers on top of 259,000 in July and 356,000 in June. That would bring the average monthly gain to 275,000 so far this year. The unemployment rate probably remained unchanged at 6.1%.

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SEPTEMBER 5, 1994



It sounds like every executive's dream: Customers clamor for so much of your product that you can't meet demand. Look at Nike Inc., scrambling to supply retailers with enough Air Madas and Air Max's. Or Ford Motor Co., adding extra shifts to make its Bronco. Meanwhile, Intel Corp. is shelling out \$2.4 billion to add computer-chip-making capacity.

This is a slowing economy? Sure, the Federal Reserve has hiked short-term interest rates five times since February to brake demand. But operating rates for some industries are heading higher, as stronger export demand augments domestic orders. The steel, lumber, and auto industries are all using 90% or more of their available capacity. And service companies are adding workers at a rate of 250,000 a month (charts). Even if the economy grows at a 3% annual rate in the second half, down from 3.5% in the first, that's still a healthy pace.

The surprise: Even in busy industries,

cost pressures have yet to gel, production bottlenecks are few, and most businesses are not raising prices. Such favorable economic conditions are created by the new business climate. Most companies face intense competition from both domestic and foreign rivals, and some executives would rather capture market share than lift margins. Costs, fortunately, are hardly growing: Isolated labor shortages in low-unemployment states and high-skill professions notwithstanding, hourly pay for nonfarm workers is rising at only a 2.8% annual rate. So businesses can make a profit without breeding inflation economywide.

CAUGHT OFF GUARD BY RED-HOT DEMAND, MANY COMPANIES ARE SCRAMBLING TO FILL ORDERS. BUT PRICES ARE BARELY STIRRING

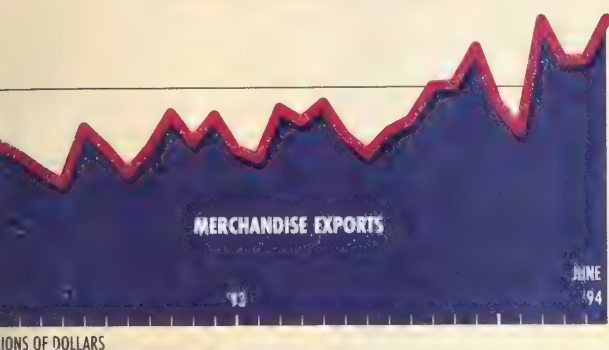
Of course, robust demand can sometimes cause quite a scramble. Take Nike's dilemma. With back-to-school buying surging past its expectations, the sneaker and clothing maker is boosting orders to Asian suppliers in a rush to answer retailers' urgent pleas for hot products, such as the Air Mada, a rugged outdoor sneaker. Says Nike Chief Financial Officer Robert

S. Falcone: "Our product is blowing the shelves. Retailers are realizing they should have ordered more six months ago." So inventories are down to five-year lows, and some retail deliveries have been delayed. Yet, with competition from Reebok International Ltd. and others, Nike has not raised its wholesale prices in the past year.

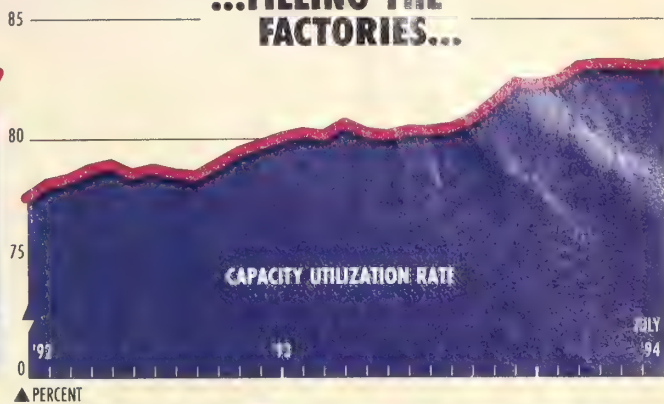
Prices of high-tech products drop the time, as computer chips keep shrinking in size and cost. But over at supply busy Intel they're plunging even faster than usual. In the second quarter, sales of its chips, including the Pentium 486 microprocessors, were up 30% from a year ago, to \$2.8 billion. Good for some cushy pricing, right? Wrong. To fend off competition, Intel has chopped the price of its low-end Pentium by 3% since April.

WATCHING WAGES. The key to ramping up output without also touching off a firestorm of wage growth and bottlenecks: productivity gains. Nomura Securities International Inc. chief economist David H. Resler argues that increased efficiency enables American industry to expand production easily without adding factories or equipment. To keep mills busy in the steel industry, for instance, companies are importing

SCENES FROM THE BOOM: EXPORTS SURGE...



...FILLING THE FACTORIES...



...WHILE SERVICE PAYROLLS SOAR



**BOJANGLES'
JOBS HAVE
GONE BEGGING**

DATA: FEDERAL RESERVE, COMMERCE DEPT., LABOR DEPT.

finished slabs, which are then rolled into finished products here.

And on Aug. 22, Ford announced it will add a third crew to its Michigan Truck Plant in Wayne, Mich., to meet demand for its popular F-series pickup trucks and Ford Broncos. By running the plant round-the-clock, Ford will increase output to 240,000 vehicles, from 200,000. Robert H. Transou, group vice president for manufacturing at Ford Automotive Operations, says: "We're aggressively looking to increase our market share and sales volume." To that end, Ford is on average not raising the price of its 1995 truck models.

But productivity gains go only so far. The booming consulting business proves it. Strategic consulting firm Monitor Group and the consulting arm of accounting firm Coopers & Lybrand, both clogged with new foreign clients, say they are beginning to turn away some new assignments. And many manufacturers are angling for big bucks to add capacity. Intel, for instance, is planning to spend \$700 million to double the output of its Santa Clara (Calif.) factory, on top of building a billion-dollar plant in Hillsboro, Ore. Two new plants, in Albuquerque and in Fontana, Calif., will come on line in 1995. To meet demand, companies are also

hiring. Typically, though, the impact on wages is relatively modest. In line with its national union contract, negotiated last year, Ford initially will pay its new workers \$16.20 an hour. While very attractive, the wage is only 70% of base union pay for existing workers. For its part, Compaq Computer Corp. says it can't find good talent fast enough to meet its growth plans—but the computer maker hasn't raised wage rates yet.

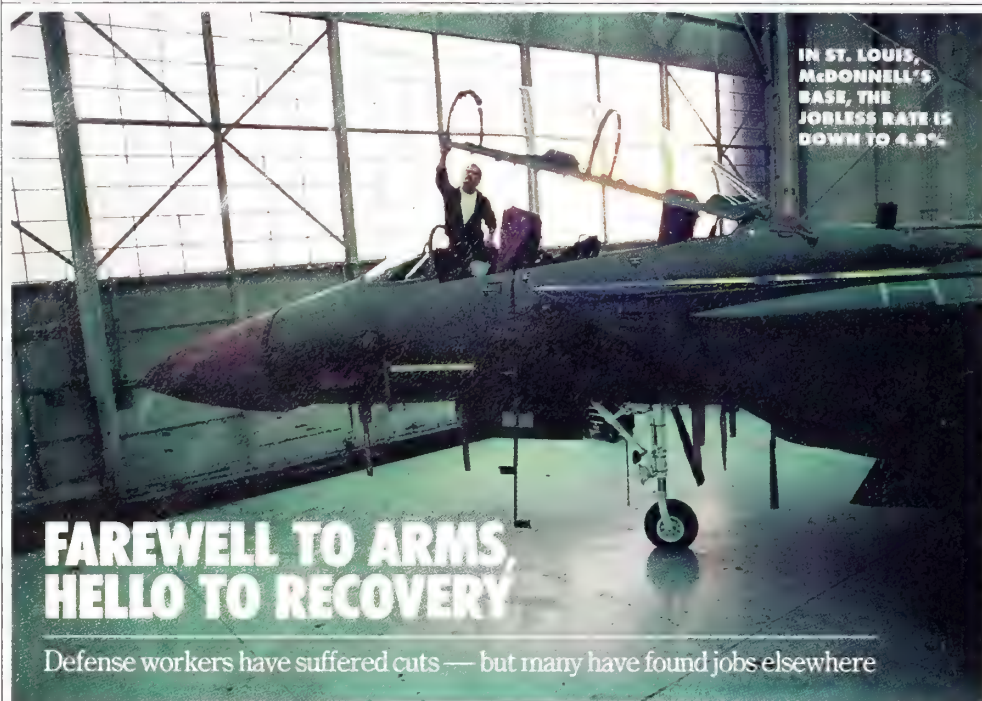
MATURE EXPANSION. That's not to say that some companies haven't been pulled into the wage-price cycle. In North Carolina, restaurant chain Bojangles' Inc. has run smack dab into the state's 3% jobless rate. The briskly expanding company has had to hike its entry-level pay, add bonuses for managers, and share workers among restaurants. Even then, jobs go begging. "One supervisor was so desperate he hired his wife to pour drinks one weekend," says Sue Finley, Bojangles' senior vice-president for concept development.

Moreover, some hyperactive industries have marked up prices a good bit. At Medusa Corp., which supplies 4% of the U.S. cement market, President George E. Uding says: "We've been producing virtually flat-out for the last several years." And with cement supplies tight

across its Midwest and Southeast markets, Medusa has been able to raise prices by 11% during the year ended in the second quarter. In the Southeast, where shortages are greatest, the company recently announced an increase of up to \$5 per ton. Another maker of building supplies, USG Corp., the largest producer of gypsum wallboard, is also running all out this year. And in the first week of August, the company announced a price hike of 10% on its wallboard.

When will this best of both worlds—fast growth and slow inflation—end for these lucky companies? Given the Fed's new hawkish bent, speedy growth may be the first to go. Lynn O. Michaelis, chief economist at Weyerhaeuser Co., estimates that it takes 12 months for rate swings to affect the real economy. This year's tightening, he says, "is an issue for 1995." Even so, by early 1995, the expansion will be four years old, and it's usually at that mature age when tighter labor markets and capacity constraints start to push up wages and prices. Nike, Intel, and others should revel in the happy mix of warp-speed growth and low costs while it lasts.

By Kathleen Madigan in New York, with Dori Jones Yang in Seattle and bureau reports



FAREWELL TO ARMS HELLO TO RECOVERY

Defense workers have suffered cuts — but many have found jobs elsewhere

Two years ago, the people of southeastern Connecticut were nervously confronting the end of the cold war. There was talk from Washington of shuttering the Groton nuclear submarine base, eliminating 4,500 jobs. At nearby Electric Boat, the General Dynamics Corp. unit that builds the subs, executives wearily planned to slash employment. Residents of an area that relies on the military for 70% of its payroll spoke of pulling up stakes and moving to the Sunbelt.

But Groton dodged the bullet. Not only did the sub base stay open, but the Navy may transfer 3,500 more jobs to town. And the Mashantucket Pequot Indians built a casino complex that employs more than 9,000. The result: The region has added 6,000 service jobs, far offsetting the 800 it lost in manufacturing, and the area's unemployment rate is just 5.3%, vs. 6.1% nationwide.

Groton's recovery is being replicated in a lot of towns where the Pentagon once provided the meal ticket. A robust U.S. recovery that has added 2 million new workers this year is handily offsetting the loss of hundreds of thousands of defense-related jobs. And the economy is finding new work in new industries

for those displaced by the shrinking defense business. "Despite all the doomsaying, the economy appears to have absorbed the cuts very well," says Bernard Weinstein of the Center for Economic Development at the University of North Texas.

FIGHTING BACK. Certainly, defense cutbacks have taken a toll. The Defense Budget Project, a Washington think tank, estimates that 1.1 million private-sector jobs have been lost since 1987, with an additional 600,000 more by 1998. "The cutbacks have been severe and involved a lot of pretty good, well-paying jobs," says Yolanda K. Kodrzycki, a senior economist at the Federal Reserve Bank of Boston. More could be coming: The Clinton Administration is mulling the cancellation or delay of such new

programs as the F-22 fighter and the Osprey helicopter.

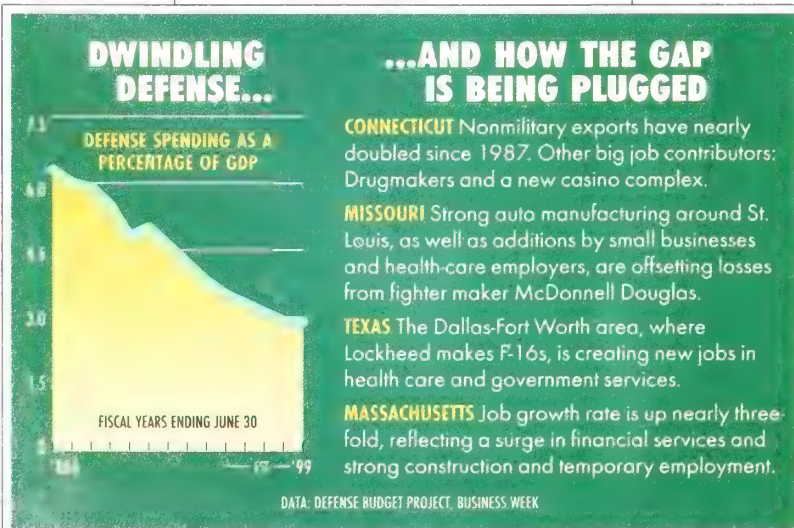
But with the exception of Southern California, where expected 30,000 more defense workers will get pink slips this year, a majority of the states most dependent on defense are doing relatively well. In Massachusetts, the boom in mutual funds has helped lift employment in Boston's mutual-fund and money-management sector by 10%. The Washington (D.C.) suburb is home to thousands of defense-related workers, are seeing unemployment rates of just about 3%—half the national average. For one, Electronic Data Systems Corp. is "aggressively selling people," according to a spokesman who expects healthy business from Pentagon outsourcing of payroll and other data services.

SHIFTING GEARS. In some cases it is defense contractors themselves that have created jobs

shifting into commercial activities or selling overseas. Martin Marietta Corp.'s missile manufacturing complex in Orlando has shed roughly 10,000 jobs since the late 1980s. But it is aggressively courting foreign business, which now accounts for 50% of revenues, up from 5% five years ago. Harris Corp., a Melbourne (Fla.) defense electronics firm, has moved 1,500 of its Electronic Systems Sector's 8,000 employees into non-defense work. Its latest win: A \$100-million contract to provide communications links for the Metropolitan Washington Airports Authority.

The job rebound involves more than defense conversion, though. In states such as Florida, diverse economies are creating employment in a host of industries. AT&T, for instance, employs more than 800 people at a microchip plant outside Orlando and is transferring new workers from out of state. Over the next six years, says Barnett Banks economist John C. Frey, Central Florida should lose about 2,000 defense jobs a year. But the regional economy created 28,000 jobs last year alone.

St. Louis, too, has bounced back quickly from the defense pullout. Home to McDonnell Douglas Co.



er of F-15 and F/A-18 fighter jets, area suffered in late 1990 and early as "Mac" laid off 10,000 workers in months. By January, 1991, the unemployment rate had soared to 7.6%.

and today? Unemployment is a paltry . A study by the St. Louis County omic Council found that by 1992, hirds of those laid off by McDonnell found work, with nearly half in the e pay range. One big provider of jobs: the auto industry, with Chrysler, starting up a second plant next and General Motors Corp. reopen- a plant to make vans.

CUTS. Even in Connecticut, which not rebounded so quickly, the unemployment rate has fallen to 5.1% since ing at 7.5% in 1992. Exports of non-ary goods have increased by \$3 bil- in the past four years—roughly the e amount by which defense contracts fallen in the state.

onnecticut is seeing an upsurge in oyment in drug research and man-uring as well as production of high- industrial instruments. Drugmaker s Inc. built a \$130 million research er in West Haven two years ago and xpanding steadily. Pfizer Inc. has ted its research workforce in Groton 0% since 1989. Even Electric Boat is g a few people in design and engi- ing as it begins work on a new class tback submarines. "The Connecticut omy has shown quite an ability to und in ways that aren't always pre- able," says state economic research etor Jeffrey Blodgett.

ven in battered California, things 't all bad. John Oldenburg's story il- rates that. For seven years, he ked as an engineer at General Dy- ies' San Diego-based Convair divi- , helping design and test Centaur ets. But a future in the aerospace ness seemed highly uncertain. "Eve- eek I was going to another friend's l-bye luncheon," Oldenburg recalls. ast July, Oldenburg followed a fellow space engineer to Aldila Inc., a mak- of high-tech golfing gear. Now, ind- of rockets, Oldenburg designs hite shafts.

ood news in defense, of course, is tive. The long-term picture for Cali- ia, Connecticut, and other states re military contracts are part of the omic fabric is one of continued nsizing. Many of the deepest cuts d come in a few years, as existing rams end production runs and new s are mothballed. Defense workers only hope the economy will keep rising people with its vigor—and d more jobs at good wages.

y Tim Smart in New Haven, with eDeGeorge in Miami, Amy Borrus ashington, and bureau reports

ARMS MAKERS LOBBY FOR A LEVEL BATTLEFIELD

Since the late 1980s, U.S. shipbuilders have watched glumly as coveted orders from Turkey for eight new naval frigates went to Germany's Blohm & Voss shipyard. Unable to offer the government financing available from German competitors, American yards weren't in the running. This time, as Ankara prepares to spend \$4 billion on up to 10 more frigates, U.S. defense companies are lobbying to end the financial handicap they say has hurt contractors as they vie for business abroad.

The industry's push for \$2 billion in loan guarantees comes just as the Clinton Administration is finishing a broad review of its policy on conventional-weapons sales. Contractors, backed by an Aug. 18 letter to the President from

makers, the U.S. Export-Import Bank is legally barred from supporting arms sales. The defense industry bristles at the moralistic rationale for the ban. "Once a defense sale has gone through the rigorous export-licensing process and been approved, it should be treated like any other export," says Dan Howard, a vice-president with Unisys Corp.'s government systems group and former Navy Under Secretary.

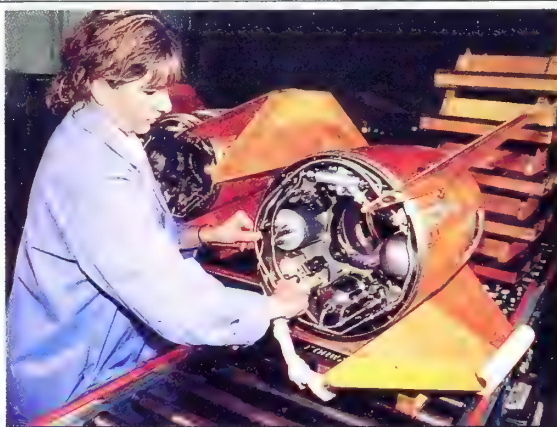
RESERVE FUND. Unisys plans to team with Bath Iron Works to bid for the Turkish frigate order, a sale Howard says requires government loan guarantees. Likewise, Rockwell International Corp. has little chance of winning \$200 million in fighter upgrade business from Greece without government support.

To mute opposition from arms-control

advocates, defense contractors are proposing a loan-guarantee scheme that would apply only to sales to NATO allies and a few other industrialized countries. And the plan would not require that Congress appropriate funds to set up a reserve for defaults. Instead, a country applying to the Pentagon for a loan guarantee would make a 15% cash downpayment, a portion of which would help establish a reserve fund. In return, the country could receive a lower interest rate because of the loan guarantee.

The Pentagon is backing contractors, because exports help reduce the unit cost of weapons. But some top State Dept. officials get queasy at the notion of official support for arms exports. And others question the industry's need for help. According to Congressional Research Service figures, U.S. suppliers accounted for 70% of arms-sales agreements worldwide last year. "People will continue to want [Lockheed Corp.] F-16s and [McDonnell Douglas Corp.] F/A-18s without favorable financing," says one Administration official. Ultimately, support for export guarantees will depend on whether the Administration believes the political good will generated by preserving defense jobs in California and other vote-rich states outweighs the flak from arms-sales foes.

By Amy Borrus in Washington



PATRIOT MISSILE ASSEMBLY: THE INDUSTRY SAYS U.S. LOAN GUARANTEES ARE VITAL FOR EXPORTS

four senators, are urging that support for the program be included in the study, which is expected to reach Clinton's desk in September. But the issue has divided the Administration. And even if the industry wins the internal White House debate, defense contractors face a tough fight on Capitol Hill, where ideological opposition to financing weapons exports runs high.

The export financing drive comes at a fateful time for the industry. With Pentagon orders dwindling, exports are vital to keep production lines going. The Defense Dept.'s recent decision to consider delaying or canceling the F-22 fighter, the Comanche helicopter, and other military aircraft contracts makes foreign sales even more imperative.

But while European export-import banks offer concessionary financing to grease exports by European arms

Commentary/by Michael Mandel

THE CRIME BILL IS BETTER THAN NOTHING—BARELY

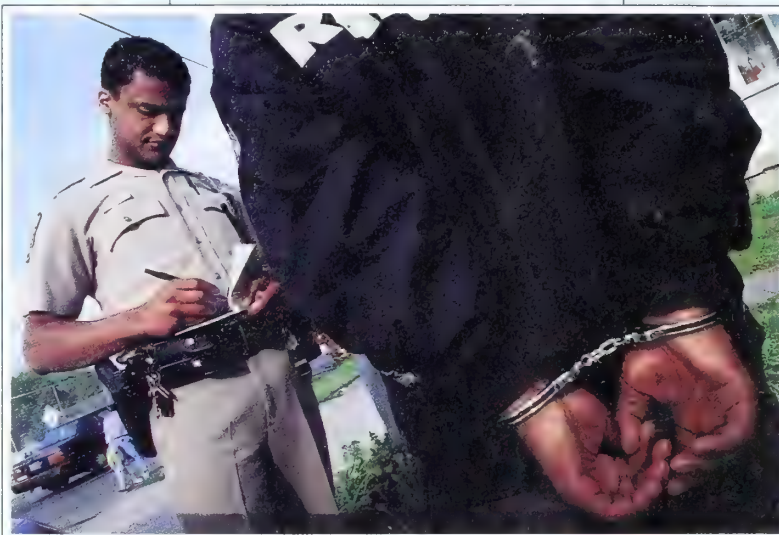
For Americans already worried sick about crime, there can be few less appetizing sights than watching Washington politicians wrangle over the so-called Violent Crime Control & Law Enforcement Act of 1994. After months of deliberation, Congress and the Clinton Administration are still laboring to bring forth a six-year, \$30 billion crime bill that covers everything from new lighting for national parks to the death penalty for fatal drive-by shootings. Will Americans be satisfied with what their money buys them?

The answer is yes—but just barely. Certainly, there's little doubt that the country needs to put more resources into fighting and preventing lawlessness. Crime costs the country \$425 billion a year, *BUSINESS WEEK* estimates. And the fear of potential crime forces many people to change their activities, their jobs, and even where they live. Given the magnitude of the problem, the size of the new bill—which would add about 5% to the sum spent on law enforcement and corrections by state and local governments—is, if anything, too small.

FOOLISH SPENDING. But the crime bill in its present incarnation suffers from a critical problem: It doesn't spend the nation's money wisely. The issue is not simply pork, of which the original version of the bill contained ample amounts. More important, the crime legislation puts too much money into new prisons and untested social programs, neither of which has proven effective in cutting crime. At the same time, the bill stints on new police and the handful of social programs known to be useful in holding down crime.

Consider: The crime bill calls for spending almost \$10 billion on prisons, boot camps, and other forms of incarceration. That strategy for crime control, however, has been tried with little

success. Since 1980, tougher sentencing laws, especially for drug crimes, almost tripled the number of state and federal prisoners. By comparison, far fewer resources were devoted to hiking the number of police per capita, which rose by less than 20% (chart). Indeed, some states, such as California, used new prisons as almost their only response to rising crime rates.



Given the magnitude of the crime problem the proposed funding is, if anything, too small

And while incarceration certainly does get criminals off the street, academics and policy analysts have found little solid evidence that that threat deters crime. The violent crime rate is up sharply since 1980, despite the prison boom, as new criminals have moved in to replace the ones sent to jail. "What we do know is that prison doesn't work to reduce the crime rate," says Marc Mauer, assistant director of the Sentencing Project, a nonprofit group advocating alternative sentencing programs. That's something that many politicians are willing to admit—but only in private.

One alternative is to add more police, who could deter crime by their presence. But in contrast to its generous funding for prisons, the

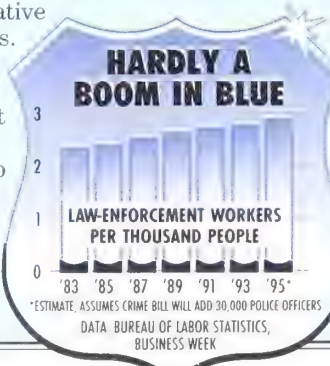
current crime bill will lead to 30,000 new police, far fewer than the 100,000 additional cops that its supporters claim. The arithmetic is simple. Over its six-year lifetime, the bill provides an average of \$1.5 billion a year to state and local governments for new police, with the recipients picking up 25% of the tab. If putting a new cop on the street costs \$60,000, including sala-

ry, benefits, equipment, and training that means only 30,000 new police. That's unfortunate, because researchers such as Ann Witte of Wellesley College have shown that increased spending on police can deter crime. **LOST CHANCE.** And while the funding of social programs as an alternative to crime is sound in principle, the bill doesn't focus on those programs that studies show to have a measurable impact on the crime rate. These are mainly intensive programs such as the Job Corps and Head Start, which can help kids before they

become the next generation of criminals. Instead, the bill now gives state and local governments \$6.9 billion for hodgepodge of untested social programs such as gang prevention and midnight basketball. While all of these sound good, there's little or no solid evidence that they bring down crime.

These defects don't mean that the crime bill is better off dead. In the war on crime, even 30,000 new cops are better than nothing. And the limit on assault weapons will surely save some lives. But given all the hoopla over the crime bill, it could have been much better—and that's the real tragedy.

Mandel wrote *BUSINESS WEEK*'s Cover Story, "The Economics of Crime" (Dec. 13, 1993).





DODGE'S WINDSTAR: SLEEK OUTSIDE, PLUSH INSIDE—BUT IT GIVES SHOPPERS STICKER SHOCK

CHRYSLER IS BURNING UP THE MINIVAN LANE

can't keep up with demand—and it has a sexy new model set for '95

In July, when Gary and Robin Long traded in their five-year-old Dodge Caravan, they didn't put much thought into deciding which new model they wanted. The suburban Cleveland couple went right out and leased another Caravan at \$289 a month on a three-year lease. They hardly bothered to look at competing models, such as Ford Motor Co.'s sleek new Windstar. "We figured, why change when we're happy with what we've got?" says Gary. Talk about driving into a headwind. The Dodge Windstar, which critics praised as the quietest, most carlike van yet when it was launched last spring, is having a tough time picking up speed against minivan pioneer Chrysler Corp. Whether it nor a new model being brought out next January by Honda Motor Co. seems likely to make much of a dent in the No. 3 U.S. carmaker's 44% share of the \$20 billion minivan market. Indeed, Japanese companies have nibbled only a tiny 7% of the market so far. And as Chrysler readies a new minivan for rollout next spring, Japan and General Motors Corp., the weakest of the Big Three in minivans, could find themselves in a battle for share a bruising one.

How feisty a competitor is Chrysler? The carefully wooed millions of its own satisfied minivan owners with direct-mail advertising and special deals so they wouldn't defect. And it offered dis-

counts of up to \$1,600 on the vans, making it tough for the Ford Windstar to gain momentum in the months since it came out.

The result: While shoppers seem to like the Windstar's aerodynamic styling and slick interior, they often blanch at its sticker price. The entry-level GL model starts at \$19,455, and the more luxurious LX, loaded with options, can run \$27,000. Dealers had hoped to charge full sticker, but several now report knocking off as much as \$1,000 to clinch a deal. "We cannot compete," laments James A. Hoffer, general manager of Jordan Auto Mall in Mishawaka, Ind. Adds John B.T. Campbell III, a California superdealer who owns a Ford franchise in Garden Grove: "We all expected [the Windstar] to do better."

To be sure, the Windstar is far from a flop. In five months, Ford has sold 50,000 of the vans. Demand could pick up a bit, too, now that Ford is finally offering captain's chairs in the rear—a popular option with parents who are intent on keeping

children separated during long trips. Already, Ford has picked up 3.6 points of minivan market share since January, though that's in large part because the company has continued to produce its aging rear-wheel-drive Aerostar minivan as well.

A KNOCKOUT. Chrysler, meanwhile, can't keep up with demand. At the end of July, it had a scant 30-day inventory of Caravans, vs. 54 for the Windstar (chart) and an average of 55 for all cars and trucks. Supplies are so tight that as of Aug. 1, the company canceled a sale on options such as air conditioning and power windows, worth up to \$1,100 per van. Moreover, when the 1995 model year begins on Oct. 1, Chrysler will raise prices: An entry-level Caravan and a Plymouth Voyager will jump \$600, to \$16,160; the long-wheelbase Grand Voyager will rise \$400, to start at \$18,605.

But Chrysler won't really start playing hardball until next year. That's when its first all-new minivan since the initial model came out in 1983 is due. The few outsiders who have seen the van say its styling is a knockout. The first public showing will be in January at Detroit's annual auto show, and sales will kick off in April.

By mid-1995, once Chrysler's factories begin operating at full speed, the minivan market could become a real slugfest. Together, Ford and Chrysler will be able to build nearly 1 million minivans a year in North America—almost the total 1993 sales of all brands in the U.S. And Honda's new minivan could have some cachet: It's based on the Accord sedan. Honda expects to sell about 30,000 of the vans a year, at a starting price of about \$22,000. The tussle for market share will likely result in "some fairly serious incentives to move the metal," says William Pochiluk, president of Autofacts Inc. in West Chester, Pa.

The company most likely to get squeezed is General Motors Corp. Its plastic-bodied, long-nosed minivans continue to sell poorly despite a modest restyling for the 1994 model year. Such models as Chevrolet's Lumina APV are already suffering. After lackluster sales in July, inventory of APVs jumped 20%, to 91 days. More's the pity for GM and other weak competitors. America's minivan wars are just getting under way.

By David Woodruff in Detroit



CHRYSLER'S MINIVANS ARE MOVING

DODGE CARAVAN (CHRYSLER)

TOWN & COUNTRY (CHRYSLER)

WINDSTAR (FORD)

CHEVROLET LUMINA APV (GM)

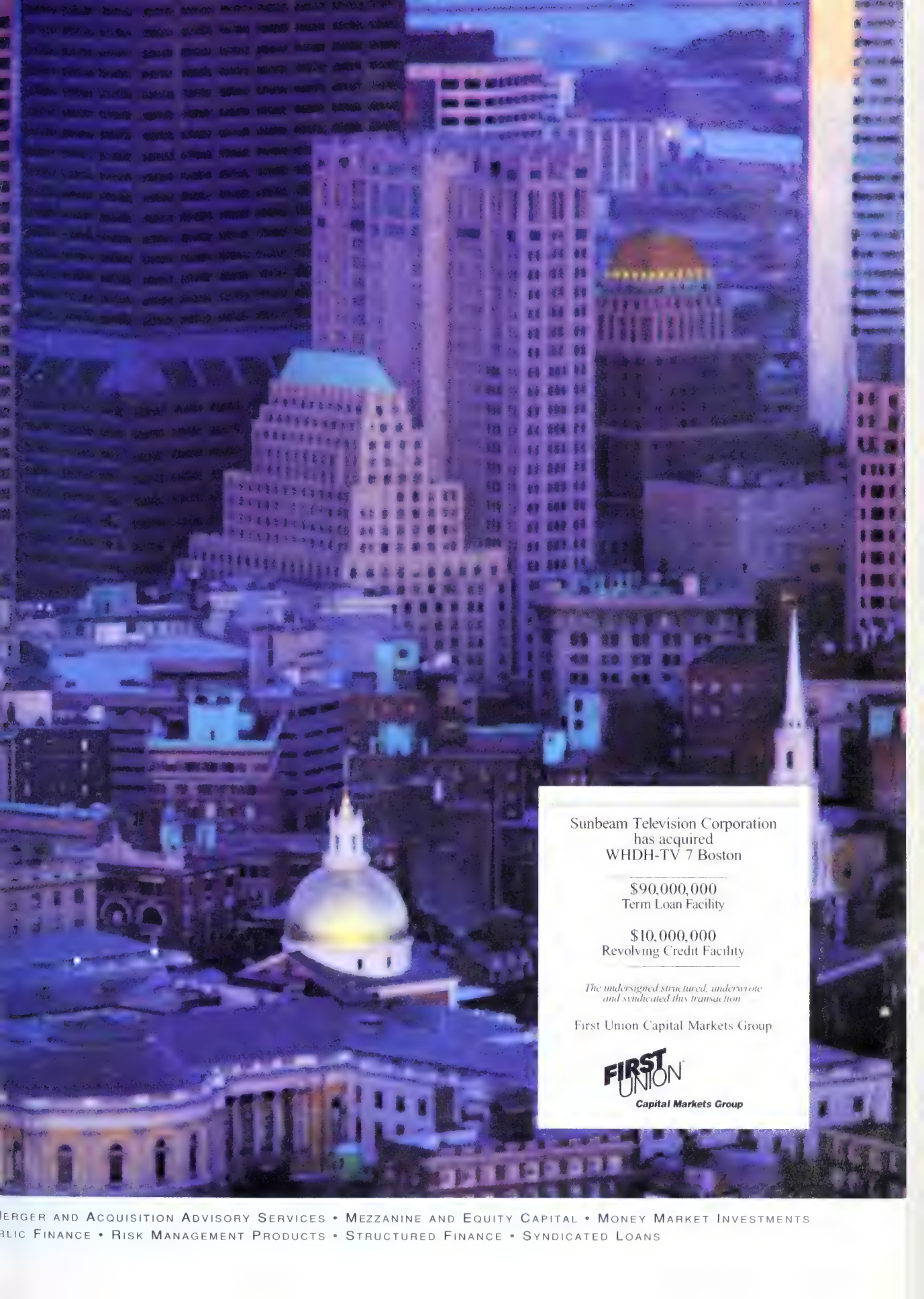
MINIVAN
INVENTORY
JULY 31

0 25 50 75 100
DAYS SUPPLY
DATA: WARD'S AUTOMOTIVE REPORTS



ASSET BASED FINANCE • ASSET SECURITIZATION • FOREIGN EXCHANGE • INTERNATIONAL TRADE FINANCE
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Sunbeam Television Corporation
has acquired
WHDH-TV 7 Boston

\$90,000,000
Term Loan Facility

\$10,000,000
Revolving Credit Facility

*The undersigned structured, underwrote
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UNION**
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EXECUTIVE SUITE

TROUBLE IN TOONTOWN

The departure of Disney studio head Katzenberg raises questions

In Walt Disney Co.'s *The Lion King*, rituals of leadership and succession form the backdrop for an animated epic. At Disney's Burbank (Calif.) headquarters, the same drama has been playing out for real since Frank G. Wells, the company's president, died in a helicopter crash earlier this year.

The Disney theatrics took yet another stunning turn on Aug. 24: Jeffrey Katzenberg, the talented and powerful chairman of Walt Disney Studios, announced he would leave the company when his contract expires at the end of September. Katzenberg had asked to be promoted to president and chief operating officer, say industry executives. When Disney Chairman Michael D. Eisner demurred, Katzenberg opted to bolt. **WRONG BRAIN.** A Disney source says Eisner resisted Katzenberg's overture because he viewed the studio chief's creative talents as too close to his own and preferred an operations brain for his second. But Katzenberg's departure couldn't come at a more awkward time. Eisner had quadruple coronary-bypass surgery in July. And while sources say he has returned to the office, Eisner's illness and Wells's death have prompted fears that Disney doesn't have an adequate succession plan.

Eisner is moving quickly to allay



KATZENBERG MADE ANIMATED BLOCKBUSTERS AN ANNUAL EVENT

those fears. "I am totally healthy. I'm 52 years old," he says. "What I need is help, not succession." Though he still will not appoint a president, Eisner notes that Disney's board has developed an undisclosed succession plan should his health take a turn for the worse: "This is not a one-man show."

More to the point, Eisner announced a split of Disney's studio into separate television and motion picture divisions. Joe Roth, a film producer who ran Rupert Murdoch's Twentieth Century-Fox Film studio, will head the movie unit. And Disney's studio president, Richard Frank, will head TV. Frank will also be responsible for Disney's nascent telecommunications business.

Still, no amount of box-shuffling will compensate for the loss of Katzenberg. The 43-year-old executive is the architect of Disney's immensely valuable franchise in animated films. *The Lion King* alone has grossed \$251 million so far

this summer. Analysts say movies such as *Aladdin*, *Beauty and the Beast*, which both grossed hundreds of millions in theater and home video sales, have become the primary engine for Disney's growth. "They're going to make animated movies," says John Tinker, an analyst at Furman Seligman & Co. Inc. "But... you don't know how critical Katzenberg was to the process."

Disney can ill

ford to lose its animation edge now. Attendance at its theme parks in Anaheim, Calif., and Orlando may drop to 3% in 1994, says Tinker. And when EuroDisney has seen its attendance drop this summer, the troubled park is far from out of the woods. Tinker dropped Disney from his list of recommended stocks on Aug. 18.

With Eisner and Katzenberg at loggerheads in the past few months, executives were already buzzing about where Katzenberg may go next. At the list: Sony Corp.'s Columbia Pictures, which has been slumping lately. But a top executive at a rival media company says running another studio would not necessarily advance Katzenberg's career: "Jeffrey clearly wants a job of corporate significance." For Eisner, Katzenberg's loss is more than a significant problem.

By Mark Landler in New York, and Larry Armstrong in Los Angeles

ENTERTAINMENT

A MARRIAGE MADE BY GUMP

By boosting Viacom stock, the hit has revived the Blockbuster deal

If Sumner M. Redstone ever makes a movie out of his proposed merger with Blockbuster Entertainment Corp., he should call it *The Deal That Wouldn't Die*. On Aug. 23, Blockbuster's board of directors voted to recommend that shareholders approve its \$7.2 billion merger with Redstone's company, Viacom Inc. The move resuscitates a deal that has been declared dead more often than Jason.

The deal was rescued, at least in part, by the hit summer movie *Forrest Gump*. Blockbuster Chairman H. Wayne Huizenga had been disparaging the merger ever since Viacom won its battle for Paramount Communications Inc. in February. His main gripe: that his shareholders are to be paid mostly in Viacom Class B stock, which had fallen from \$42 to as low as \$21 because of the debt Redstone took on to pay for Paramount. But now, propelled by *Gump*, Viacom has rebounded to \$34. That gives investors a slim premium over Blockbuster's \$6.6 billion market value.

Of course, Block-

REN AND STIMPY: NICKELODEON MAY GO GLOBAL



buster shareholders could still emerge when they vote on September. Stocks of both companies fell a bit after the board action. Kenneth J. Berman, portfolio manager at Massachusetts Financial Services Co., which owns Viacom shares, wants assurances that Viacom will invest Blockbuster's rich cash flow in other businesses, rather than use it to pay down debt. And he wonders if Blockbuster executives will have any role in the new company.

Viacom is expected to answer both questions. Redstone says Blockbuster will generate more cash flow than expected, which will allow him to proceed with two projects: a new Paramount studio and a global Nickelodeon.

MOVING TOWARD BORDERLESS PATENT

The U.S.-Japan agreement is a small but important first step



BRUCE A. LEHMAN DOESN'T WANT SO-CALLED SUBMARINE PATENTS TO LINGER IN SECRET

Bruce A. Lehman has a vision: a new era in which patents will be protected from global rip-offs. The high-talking commissioner of the U.S. Patent & Trademark Office wants to tear down barriers to American inventions in the patent systems of Japan, Europe, and the U.S. He and other patent experts even imagine a future in which application in one nation's patent office could garner an inventor worldwide protection. The result, he says, would be

Expanding Nick in Asia and Europe could cost \$200 million over three or four years. Executives close to Viacom suspect Blockbuster President Steven Hirsch to stick around after the merger. Others say Huizenga probably won't be a top operating job at Viacom. So he is up and leaving.

While, insiders say Viacom is within a deal to sell Madison Square Garden at least \$1 billion. Viacom's talks with Tele-Communications Inc. about selling its systems are going more slowly. Both deals soon would really help Redstone could use the proceeds to \$1 billion or more off its \$10 billion and he could assure Blockbuster shareholders that he wants their company underlying value—not just as a check-pay for Paramount.

Mark Landler in New York and Gail Jaffe in Miami

a big boost for U.S. competitiveness.

On Aug. 16, the world inched closer to that grand vision when the U.S. and Japan inked an agreement to make changes in their patent systems. If Congress approves, Lehman will bring the U.S. system in line with Japan's and Europe's by publishing patents 18 months after filing instead of keeping them secret until they are granted. He will also implement a General Agreement on Tariffs & Trade (GATT) provision to change the 17-year patent life after granting to a 20-year term from the filing date. Meanwhile, Japan will speed up patent examinations, eliminate challenges to pending patents, and allow companies to apply in English.

The agreement hasn't been universally hailed, of course. Japan's changes "aren't worthy of the concessions we've made," sniffs Jerome H. Lemelson, 71, a prolific inventor who holds 500-odd patents. Lemelson and other critics fret that a 20-year term in the U.S. means that approval delays would dramatically reduce the useful life of a patent. Moreover, they scoff, all that the Japanese offered in return is faster patent reviews—a goal they have espoused for years.

But business—which has complained loudly about obstacles in the Japanese system—in general applauds the accord. By challenging others' submissions and flooding their patent office with applica-

tions, for example, the Japanese have caused lengthy delays in patent approval. "For years, pre-grant opposition has been a thorn in our side, using up precious patent term," says John J. Klocko III, associate general counsel for DuPont Co. Japan's concessions, if enacted, "will make it more difficult for the competition to slow down an important patent," says Boston University law professor Robert P. Merges.

Still, most U.S. companies want a lot more. Japan's patents are far narrower than the American equivalents, says William S. Thompson, former general patent counsel for Caterpillar Inc. That has made it impossible for Caterpillar and other U.S. multinationals to protect key innovations because products very similar to theirs can be patented without causing infringements.

WIN-WIN SITUATION. Lehman and others argue that changes in the American system are long overdue. U.S. companies have been increasingly concerned about so-called submarine patents—applications for major innovations, such as the basic microprocessor, that linger in secret in the patent office for decades due to indecision about patent approval. For instance, when the microprocessor patent was finally awarded to inventor Gilbert P. Hyatt in 1990, after 20 years, companies such as the North American Philips Corp. had to scramble to license it.

Altering the patent term and publishing patent requests after 18 months will get these applications out into the open and limit their disruptive effect, experts say. And using the carrot of U.S. compromises to persuade Japan to make concessions was "a brilliant strategy," says patent lawyer and George Washington University law school professor Harold C. Wegner—although many experts say Japan's patent commissioner shrewdly realized that the changes were in Japan's interest as well.

The major import of the patent deal, however, may be that anything happened at all. Until now, more than 20 years of efforts to reconcile the world's patent systems have come up virtually empty. "This is a very big step toward harmonizing the entire world's patent system," says Yoichi Omori, a director with the Japanese Patent Office.

Still to come are some major issues. Among the most important ones: whether the U.S. will join the rest of the world in granting patents to those who file first, as opposed to those who can prove they came up with an invention first. And whether Japan will grant broader patents. But the world already is a step closer to reinventing the protection of inventions.

By John Carey in Washington, with bureau reports



COLLIER COLE (LEFT) AND FRIEND, MALL-SURFING: "I'M NOT A PREPPIE. I WEAR WHAT I LIKE"

OH MOM, THOSE JEANS ARE, LIKE, SO FIVE MINUTES AGO

How do retailers satisfy back-to-school fashion whims? First, they pray

It's a fine August day, and 16-year-old Collier Cole from Lake Forest, Ill., is reveling in the many wonders of nearby Hawthorn Center mall. Shoes? Collier already owns seven pairs of Converse high-tops in as many different colors—but one more pair couldn't hurt. How about some tie-dye? And a couple of flannel shirts. And jeans.

"I don't have a significant style," she says. "I'm not a preppie. I wear what I like."

Auugh! Retailers find Collier as, like, exasperating as her mother does. It's the start of the back-to-school season—the two months in which the nation's 28.5 million teenagers, with their parents, will spend close to \$9 billion, about one-half their total annual clothing tab. After two anemic years in a row, the fashion industry is hoping for a break.

But it won't be a sure thing. "The teen market is very difficult," complains Kal Ruttenstein, fashion director for Bloomingdale's Inc. "When there's a novelty aspect to clothes, they like it, but they get tired of it quickly. When you hit it right, that's great, but peer pressure is much stronger than any fashion message a store

can sell." Between whims and mood shifts, it's a difficult game to call. "It's a hormone-driven business," says retail consultant Alan Millstein.

After a two-year stand at the top of the teen-clothes heap, for example, the amalgamation of ripped jeans and tattered flannel known as grunge is out. Very out—though its spirit lives on, some teens say, in a restyled sort of preppie look that's "bigger, or more beat-up, or looser, or something," according to Jean Brownell, a San Francisco 16-year-old.

MINI-TARTANS. What's in? "For skirts, the new thing is plaid," says Erin Mur-nane, 12, of Johnson City, Tenn. Mini-tartans found their way into department stores after two seasons on fashion runways. Cut well above the knee, they're often matched with black stockings

stretched to the thigh and with updated round-toe versions of Mary Jane shoes—or clunky boots. Suspenders are optional; the safety pin, designers' one concession to modesty, isn't.

For the doubly hip teen, how about an accessory in silver? Silver-colored biker boots and miniature backpacks are sparkling on the shelves and at the cash register this year, according to Sears, Roebuck & Co. trend manager Kathie Betts. "Our junior customer has a sense of humor about what she's wearing," she says of teens' often-offbeat combinations.

The less adventurous retreat to the comfortable world of blue denim and T-shirts. This is the stuff for kids such as Joe Spitz, a high school senior in Philadelphia and self-described "regular person." His style: jeans, with baseball caps and Nike shoes. In fact, J.C. Penney Co.'s top seller this season is classic five-pocket jeans—good news for Levi Strauss & Co., which counts on back-to-school as its biggest season.

Sneakers remain a hot category, accounting for \$3 billion in teen sales in 1992. Teenage Research Unlimited, marketing consulting firm in Northbrook, Ill., found Nike the brand most often mentioned by teens as "coolest." But blue-suede Pumas and Converse high-tops are back in, too.

SENSIBLE SHOPPERS. Can designers and retailers sort all this out? The season has started "a little on the disappointing side," says retailing consultant Kurt Barnard. Teenagers, he says, are earning less at part-time jobs than they used to, so discretionary spending is weak. Their surprisingly rational drive for value has pressured pricing. "Department stores have moderated price points on apparel and taken the specialty store head-on," says Irwin Cohen, a Lilloitte & Touche partner.

As a result, says Barnard, stores such as Penney's and Sears should have relatively soft teen sales this autumn. The Limited

Too, which caters to girls up to age 16, says sales have been very good at its 200 mall-based shops. In fact, says consultant Murstein, "this could be the best fall in five years." Unless teenagers change their minds.

By Nanette Byrnes
New York, with Sandra Atchison in Denver and Alice Cuneo in San Francisco

HOW TO TALK FASHION WITH A TEENAGER

A brief guide to current trends

MINI REDUX

Grunge meets New England preppie. Short plaid skirts, often with suspenders, tall socks, and work boots.

FOREST CHIC

Unisex anoraks, reflective clothing, overalls. Inspired by environmentalism—and by Stallone's *Cliffhanger*.

SPACE SHOTS

Silver knapsacks, boots, and jewelry. Moon-landing nostalgia, or just an adolescent twist on haute couture.

SAFE STANDARDS

Can't decide? Stick to the middle ground: Jeans, T-shirts, baseball caps—the last worn backwards and askew.

ASCENT MBAs TAKE THEIR SHOW ON THE ROAD

Second-tier schools and their students are actively recruiting recruiters

The Merry Pranksters they're not. But like Ken Kesey's frenetic band of youthful travelers, a half dozen students from the University of Texas began a raucous journey on Aug. 1 in search of their own futures. Over the next few weeks, they'll put some 10,000 miles in a Ford van to court 125 would-be employers.

The object: recruit the recruiters. The marketplace for graduates of Texas and other second-tier business schools is becoming increasingly tough. Many of the big companies that once favored MBA programs have cut back sharply. And while investment banks and consultants are flocking to campuses again,

sees a simple solution: "If the corporation is the customer and they're not calling on you, you have to call on that customer."

That's exactly what several schools are doing. Administrators and students at the University of Tennessee, Texas A&M University, Tulane University, and the University of Georgia are actively pursuing employers. "We have to market ourselves to remain competitive," says C. Warren Neel, dean of the University of Tennessee's B-school. "By sending our students out into Corporate America, we show the recruiters that our program is relevant to their needs."

Relevance, of course, is in the eye of

Thus far, though, Texas' effort is the most ambitious. The campaign is the outgrowth of a 1992 McKinsey & Co. study that found that many MBA recruiters avoided the school because it attracted younger students with less polish than those at peer institutions. Dean Robert E. Witt responded by making extensive work experience an admission requirement and by further diversifying Texas' once regional student body.

GORDIAN KNOT. To spread the word, students came up with the idea for the tour. Sam Turcotte, the group's leader, raised about \$20,000 from corporate sponsors: Ford Motor Co. donated the roving van, and Apple Computer Inc. lent computers, laser printers, and electronic message pads. American Airlines Inc. tossed in airplane tickets so that rotating teams of four could join Turcotte on the road. Armed with a 90-pound Gordian knot—the better to symbolize their problem-solving prowess—the MBAs hit the road.

After the road tour, a separate group of 28 students will make follow-up phone



AMERICAN AIRLINES EXECUTIVES COURTED BY TEXAS MBAs: THE TOUR WAS THE STUDENTS' IDEA

They're mainly visiting places such as Harvard and Stanford.

As a result, the opportunity gap between elite MBA schools and the second tier appears to be widening. This year, only 4% of the graduating classes at Northwestern University's Kellogg Graduate School of Management or Massachusetts Institute of Technology's Sloan School were without job offers by commencement. Compare that with Ohio State, where 40% of grads lacked a single offer at graduation (table).

GRILL BARBECUE. The battle lines are clear. "MBAs from second-rank schools generally aren't going to be hired by the big firms like the Citibanks," says Peter C. Thorp, director of Citibank's recruitment program. Thorp, whose company recruits about 400 MBAs yearly,

the beholder. At Texas A&M, students plan to woo 30 companies with a down-home Texas barbecue and an informative conference on their B-school program. The two-day "sell" weekend in September will allow Aggie students to interact with recruiters from such large companies as Texas Instruments Inc. and Price Waterhouse. A&M MBAs hope the networking will translate into jobs.

Students at Georgia take a more cerebral approach. MBAs research cities and companies that fit the students' areas of interest. After screening out uninterested firms, teams of five MBAs, along with school placement head Lisa Ransom, visit recruiters, hoping to bring them to campus. The effort has lured six new companies, including Michelin Tire Corp. and AT&T.

THE MBA RECRUITING DIVIDE

Percentage of Class of 1994 without a job offer by graduation

TOP TIER

MIT (SLOAN)	4.0%
NORTHWESTERN (KELLOGG)	4.5
DARTMOUTH (AMOS TUCK)	11.0
STANFORD	16.0

SECOND TIER

OHIO STATE	40.0%
GEORGIA	30.0
TEXAS AT AUSTIN	24.0
TULANE (FREEMAN)	24.0

DATA: SCHOOL REPORTS, BUSINESS WEEK

calls and visits. Their message: "Texas MBAs have first-tier business skills without the '80s attitude," claims Turcotte. "We're down-to-earth, we work hard, and we're willing to put in the long days needed to help companies."

So far, so good. Corporate recruiters such as American Express Co. and Sara Lee Corp. think the idea is novel enough to meet with the group and hear the pitch. "Students on the road can establish lasting relationships with the recruiters," says Rick Perez, an Apple account manager who arranged for the company's sponsorship. That's not something Kesey's pranksters, who displayed absolute contempt for corporate life, would countenance. But it's exactly what Texas' MBAs need to compete.

By Jeffrey Glasser in New York

EDITED BY KEITH H. HAMMONDS

THE PC BATTLE MAY BE BLOODLESS

Price war! Or maybe not. At first glance, IBM's personal-computer price cuts of up to 27%, announced on Aug. 24, seemed likely to fuel industrywide slashing, coming a week after a similar gambit by Compaq Computer. But these combatants may not shed much blood after all. Average PC prices have stayed within 5% of \$2,000 for six straight quarters, and makers cut prices every year before introducing new models for the Christmas quarter. The real slashing may come next year, when Compaq is expected to push sub-\$1,000 multimedia machines. "I have

no doubt that Compaq controls pricing in the industry," says Dataquest analyst Kimball Brown.

RESERVED SEATS AT GREYHOUND

Greyhound Lines, it appears, has finally mollified its investors. In an extraordinary effort to make peace, the bus company announced Aug. 24 that it would immediately grant three seats on its nine-member board to Connor, Clark, the Toronto firm that is its largest investor. Only two weeks ago, under pressure from investors unhappy with poor results, Greyhound Chief Executive Frank Schmieder stepped down. Then, Connor Clark rejected an offer of two seats tied to several conditions, such as the demand that Connor Clark wouldn't contact current or former Greyhound directors, employees, or suppliers. Now, though, the two sides say they will work together "to rebuild Greyhound's financial strength."

NEUTROGENA'S CHAIRMAN CLEANS UP

The big winner in Johnson & Johnson's acquisition of Neutrogena, announced on Aug. 22, will be Neutrogena Chairman Lloyd Cotsen: His 38% stake is worth \$348 million. But Cotsen, who started at the soap-and-shampoo company in 1957, after marrying the boss's daughter, has had a career fraught with family tragedy and intrigue. In 1979, his wife and teenage son were found murdered at home in Beverly Hills, Calif. Police suspected a business rival involved in a bitter dispute over Neutrogena trademark rights—who later committed suicide. And Cotsen's second wife filed suit in 1992 charging him with failing to deliver \$1.5 million worth of Neutrogena stock he had

HEADLINER

MCDONALD'S HOT COFFEE GETS HER COOL CASH

It's a crappy cup of coffee that burns your tongue," rails attorney S. Reed Morgan. Granted, a cup of Joe at McDonald's may not match Starbucks' fancy brew. But Morgan has made a career of attacking those piping-hot, 65¢ cups. His latest victory: A \$2.9 million award for 81-year-old Stella Liebeck, after she spilled a cup of McDonald's coffee in her lap.

An outrageous sum? Not at all, insists Morgan. Liebeck (photo) suffered third-degree burns that required a hospital stay and skin grafts. And Morgan claims McDonald's officials have known about hundreds of java-related injur-

ies dating back to 1978. In 1988, Morgan won \$27,000, a 29-year-old woman who spilled McDonald's coffee. Two years later, McDonald paid a Santa Monica (Calif.) woman \$235,000. Morgan's official didn't return phone calls.

Morgan—who says he was prepared to settle the Liebeck case for a mere \$300,000—produced an array of burn experts and dermatologists who testified that McDonald's could easily solve the problem by serving cooler brew. "Why can't they make a decent cup of coffee," he complains. Lucky for him they don't.

By Eric Sch



promised. Cotsen denied the charge.

A FRIENDLY NICHE FOR UNITED'S WOLF

Former United Airlines Chairman Stephen Wolf wasn't unemployed for long. Jobless after the July employee buyout, Wolf announced on Aug. 24 he would join Lazard Frères as a senior adviser. The firm shouldn't have trouble paying his undisclosed salary: While other bankers hammered out details of the deal, Lazard earned a \$5 million "success fee" for bringing United's unions back to the negotiating table last December after talks broke down.

FROM ACADEME TO THE CHICAGO FED

He wasn't one of the favorites. But Michael Moskowitz, named on Aug. 23 to take over as president of the Chicago Federal Reserve

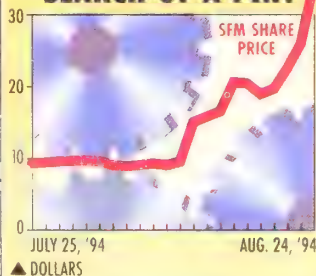
Bank, brings impressive credentials: Recently, Moskowitz has been teaching international management at Northwestern University's J. L. Kellogg Graduate School of Management. Before that, he served for two years as deputy U.S. Trade Representative. He also has business experience, having been a senior executive at Esmark and Northwest Industries. Moskowitz's influence will be felt soon: Next year he becomes a voting member of the Federal Open Market Committee.

ET CETERA . . .

- Ralph Lauren sold 28% of his haute-prep fashion house to a Goldman Sachs unit.
- Digital Equipment dumped its Olivetti stake, at a cost more than \$100 million.
- Stronger growth will cut the budget deficit, to \$162 billion in fiscal 1995, the CBO says.
- The other shoe drops: Novell: It will cut 1,750 jobs in merging with WordPerfect.

CLOSING BELL

A BUBBLE IN SEARCH OF A PIN?



Is this another Andrea Electronics or Spectrum Information Technologies in the making? The stock of SFM Corp., a tiny New York-based maker of toys and motors, has quadrupled in value since Aug. 10, when the company announced sharply higher profits. The stock price rose by 6% on Aug. 24 alone, to 35. The day before, SFM—which up till then had not offered any comment on the stock's activity—reaffirmed plans for a company reorganization and a 4-for-1 stock split. Details of the proposal, however, had been public for weeks. Says SFM Chairman David Segal, who holds more than 300,000 shares: "I really don't know what to make of it."

DATA: BRIDGE INFORMATION SYSTEMS INC.

Parlez-Vous Binary Code? The Engine And Transmission Do.

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The ES



IS BENTSEN CLIMBING BACK TO THE TOP OF THE HEAP?

Why is Lloyd M. Bentsen smiling? It wasn't a great year for the Treasury Secretary. His department was submerged in the Whitewater scandal, which forced out two top aides. Treasury was widely blamed for President Clinton's incoherent dollar policy, and its plan to streamline federal banking supervision was torpedoed by the Federal Reserve. Worse, Washington gossip—some from the White House—dismissed the Administration's 73-year-old *eminent grise* as out of gas, out of the policy loop, and soon to be out of work.

So much for conventional wisdom. Bentsen is not only secure in his job, but he and new White House Chief of Staff Leon E. Panetta—another Capitol Hill veteran—are emerging as the dominant players in shaping the President's agenda and selling it to Congress. Their centrist views, pragmatism, and skill in forging bipartisan compromise will be even more important for Clinton next year when he is sure to face a more heavily Republican legislature.

Clinton now realizes that he desperately needs the kind of insider's knowledge that a 40-year veteran of Washington provides. After the battering he took on his legislative priorities earlier this year, Clinton is leaning on the wily Bentsen to get his top causes—the crime bill, health-care reform, and a new General Agreement on Tariffs & Trade—through Congress. The Treasury chief is working his old congressional friends, and he's providing the President with blunt counsel on how to cut deals in Washington. Bentsen, Clinton admitted recently, "talks in such a frank way to his President when I need to be frankly spoken to."

The best example: health care. Last year, Bentsen tried to persuade Bill and Hillary Rodham Clinton to scale down their ambitious plan, but they ignored his advice. Now, with Congress spurning the White House plan, Bentsen is trying to sal-

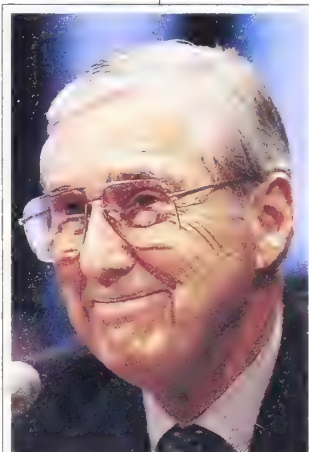
vage more modest reform—one that's closer to a plan he proposed in 1992 as chairman of the Senate Finance Committee.

Whitewater shows just how much clout Bentsen still has on the Hill. Deputy Secretary Roger C. Altman and General Counsel Jean E. Hanson quit after being hammered at congressional hearings for contacting the White House about a criminal probe of a failed Arkansas thrift linked to Clinton. But Bentsen was treated with kid gloves. "He has a reputation for integrity, so you believe him," explains former Senator Warren

B. Rudman (R-N.H.). Adds a Bentsen aide: "It helps having been a member of the club."

SWIFT MOVE. Not only did he dodge a bullet, but the savvy Bentsen turned the Whitewater mess to his advantage. From his first days on the job, Bentsen was frustrated that some top aides were thrust upon him by White House political operatives. Minutes after Altman and Hanson announced their departures, Bentsen put out the word that he would fill the slots with his own people: Under Secretary Francis N. Newman would replace Altman, and longtime Bentsen aide Edward S. Knight would replace Hanson. Administration aides say it was extraordinary for a Cabinet officer to preempt the White House on naming Presidential appointees. "Only Lloyd could get away with that," says one Presidential adviser.

Bentsen's lightning move did more than let the White House know who's in charge of Treasury. Aides say it's also his way of refurbishing the department's tarnished image. Bentsen himself says he's not looking back: "I'm not interested in putting anything behind me. I'm too busy getting on with the work of Treasury," he says. And although friends say he was uptight before the Whitewater hearings, Bentsen's mood couldn't be better these days. "With the economy performing so strongly," he says, "this job's a lot of fun." Given his newly regained clout, it's no wonder.



"THIS JOB'S A LOT OF FUN"

CAPITAL WRAPUP

HEALTH CARE

Big Business may borrow a page from Clinton's playbook to stop Democrats' health-care bills. Some trade groups are preparing to set up a "war room" to direct lobbying. The 13 organizations, from the National Association of Manufacturers to the National Restaurant Assn., are pooling information and buying ads together. They say they'll go into the bunker if the fight gets so hot that they need instant coordination. But some lobbyists are skeptical. Reminded that Clinton favors war rooms, one quips: "Yet another reason not to do it." Meanwhile, IBM emerges as a key player. It orga-

nized 60 companies to support an ad run in 16 newspapers on Aug. 23, charging that Democratic bills will hurt employees of multistate companies.

U.S.-RUSSIA

President Clinton hopes to dump one of the last relics of the cold war when Russian President Boris N. Yeltsin visits Washington in late September. Clinton is expected to sign an order finding Russia in compliance with the 1974 Jackson-Vanik Amendment, which had denied the Soviet Union most-favored-nation trade status because of its restrictions on Jewish emigration. Congress must approve the order before Russia can get full benefits.

LABOR

Business predictions of a pro-labor tilt at the National Labor Relations Board in a Clinton Administration are proving out. Since former Stanford University law professor William B. Gould IV was confirmed as NLRB head in March, the board has gone to federal courts 47 times to reinstate fired workers in labor disputes, vs. 4 such actions taken in all of 1993. Gould also wants to let workers vote by mail on whether to form collective-bargaining units. He has shelved the idea for now, after business groups, fearing mail ballots could revive flagging union membership, threw a fit.

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Make The Connection

MEXICO

HIGH HURDLES AWAIT ZEDILLO

FIRST, HE MUST ENGINEER GROWTH—AND FAST

Blanca Estela Morales was pleased. The 34-year-old housewife from the sugarcane-growing town of Jotutla had voted for Ernesto Zedillo Ponce de León for President. Now, her man, candidate of the long-ruling Institutional Revolutionary Party (PRI), was the winner of a hard-fought race few thought the PRI would win so decisively. But Morales wants to see Zedillo get right to work solving Mexico's deepest problems. "They need to create more jobs," she says. "They can support small shop owners and help companies to mechanize. There's money to do it."

That combination of optimism and impatience is what President-elect Zedillo faces as he is catapulted into Mexico's driver's seat. When he takes over the reins from President Carlos Salinas de Gortari on Dec. 1, he'll be launching the second phase of Mexico's massive modernization. Painful as it has been, Mexicans voted to continue their makeover from a protected economy into an open, trade-oriented nation, tied to the U.S. Despite a nasty recession and a growing gap between rich and poor, apparently there was no going back.

COMPROMISE. That news drew sighs of relief from Mexico City's *bolsa* to U.S. boardrooms. Despite an unprecedented flurry of political poll-taking, no one really knew just how Mexicans would feel after a tense year of rebellion, assassination, and lousy economic performance. The Mexican stock exchange perked up 3.5% since the election, and analysts predicted it would climb another 20% by yearend. The peso, weakened a bit by pre-election devaluation jitters, rose, too, to 3.33 pesos to the dollar. U.S. companies with stakes in Mexico dusted off expansion plans, which had been put on hold pending the election outcome. Says Howard M. Dean, CEO of

Dean Foods Inc., a Franklin Park (Ill.) food company: "It's good for us. We're just going to increase [sales] in Mexico as fast as we can."

But if economic reform emerged unscathed, the necessity of political reform was the election's strongest message. For this was like no other election in Mexico's history, generating an unprecedented 75% voter turnout. Never before had the PRI been forced to run so hard or been so scrutinized for election

fraud. So while the PRI won nearly 50% the strong showing of the center-right National Action Party (PAN), with 27% of the vote, along with the smaller, 17% vote for the left-of-center Democratic Revolutionary Party, added up to one of the largest opposition votes ever.

That vote will give the PAN, at least some clout in a more plural congress. Although the PRI kept its wide majority in the Senate and thin one in the Chamber of Deputies, it will now have to compromise on legislation—something never had to do in the past. Whether Zedillo, who never held elective office before, has sufficient political savvy to cut such deals is yet to be proven.

What's more, the Yale University-educated economist will be fully challenged getting Mexico's economic balance just right. Salinas leaves his protégé with an impressive ledger book for the macroeconomy: single-digit inflation, low public debt, and many successful privatizations. But Salinas is also criticized for cutting too close to the bone, helping to create a new class of billionaires in Mexico as millions got left out of the

HOW ZEDILLO COULD MAKE MEXICO GROW

DECENTRALIZE FEDERAL POWER

Turn over more tax revenue to the country's 32 states to stimulate regional growth

BOOST ASSISTANCE TO INDUSTRY

Offer low-cost financing for smaller companies to upgrade technology and give tax incentives to larger ones for R&D

REFRAME EXPORT POLICY

Encourage exports in areas in which Mexico has a competitive advantage

THE ZEDILLOS
MEXICO'S NEW
PRESIDENT IS
WELL-EQUIPPED
TO MANAGE THE
ECONOMY—BUT
HIS POLITICAL
SKILLS ARE AS
YET UNTESTED



economic miracle. "Some of the administration's policy gaps are large," says Roberto E. [unclear], who heads Arthur D. [unclear] Mexicana consultants. Now, the big challenge will be to engineer growth. Zedillo's brain trust is well-equipped to help with the fine-tuning. Among his closest advisers are members of the Salinas cabinet who would be reassigned to the new administration, including Jaime Serra Llovera, currently Trade & Industrial Development Secretary, and Guillermo Ortiz, the Finance Under Secretary overseeing the opening of Mexico's financial markets to foreign

banks and brokerages. Some speculate the current Finance Secretary Pedro Pablo Kuczynski may be named to revamp Pemex, the hugely inefficient state-owned oil company, as a first step toward partial privatization of the monopoly. Although reform policies have been criticized as lacking in compassion, their presence should reassure investors at home and abroad. And Zedillo could name a prominent figure to head up the social portfolio to mollify critics.



AT A MAQUILADORA A MARKET FOR MEXICAN PARTSMAKERS?

Already, a few small signs of health are emerging. After nearly a year of recession, the economy expanded by 2.2% in the first half of 1994. Although much of that growth was turbocharged by a 28% boost in pre-election spending, a slow recovery may be in sight. More than a dozen foreign banks have applied to operate in Mexico, which will help reduce borrowing costs. And now, with political uncertainty waning, direct foreign investment should rise. Nonportfolio investment

was up 25% during the first half of this year, vs. 1993's first half.

The trick will be to make sure more Mexicans get a piece of the action (table). Zedillo must start with jobs, say economists. Job training and education are crucial for the 1 million Mexicans entering the workforce each year. The government also can help smaller companies upgrade manufacturing as they meet importers head-on. And in areas where Mexico could have a competitive advantage under the North American Free Trade Agreement, such as auto parts, construction supplies, and agroindustry, the

government "must target several that can serve as locomotives for growth," says Jonathan E. Heath, economist at Macro Asesoría Económica, a Mexico City think tank.

NURTURING. Another sector ripe for change: the *maquiladoras*. Fewer than 2% of components for these factories are supplied by Mexican companies; most come from U.S. suppliers. Arthur D. Little's Batres figures Mexican suppliers could provide up to 25% of components, worth \$2.5 billion a year. All it would take is low-cost, government-backed loans to improve distribution and marketing. But free-market purists in the government nixed the notion when Batres proposed such a program.

Such free-market orthodoxy may be softened in the new *sexenio*, or six-year term. To pay for new programs, Zedillo, a fiscal conservative, will have to overcome his revulsion for deficit spending. He has already pledged to boost spending by 0.8% of gross domestic product next year. That translates into a deficit of 2% of GDP, hardly enough to throw the economy off course. And with many companies sinking under NAFTA, Zedillo will have to begin nurturing some industries. Some possibilities: tax incentives for research-and-development spending and job training to help move Mexico away from sweatshop employment.

With so many pressing problems, Mexico's new President won't get much of a honeymoon. Not only will he have to justify his supporters' optimism, but he also must overcome the skepticism of citizens who voted against him. María del Carmen Suárez, 42, who runs a stationery store in a poor neighborhood on Mexico City's outskirts, is convinced Zedillo "will improve things only for himself and for Mexico's 24 billionaires." It will take Zedillo's economic skills, plus his as-yet-undemonstrated political skills, to prove Suárez wrong.

By Geri Smith in Mexico City, with Elisabeth Malkin in Jojutla



loges, such as auto parts, agroindustry, construction materials, and textiles

SPEND MORE ON INFRASTRUCTURE

Invest in projects such as highways, schools, and hospitals that create jobs and improve social conditions

INVEST IN HUMAN CAPITAL

Spend more on education and job-training programs to prepare for higher value-added jobs

INCREASE COMPETITION

Give the antimonopoly commission more teeth to break up unfair trade practices and encourage competition

DATA SOURCES: WEF, MACRO ASERORIA ECONOMICA

A NEAT U-TURN IN EUROPE

Carmakers are out of the slump but still face a tough foe: Japan

Last year, Europe's auto makers fell into the abyss. Sales crumpled a catastrophic 16%, to 11.3 million units—the sharpest recession since World War II—and four of the Big Six manufacturers lost money. Italy's Fiat posted the biggest loss in its 95 years and paid no dividend for the first time in more than 40 years, while even profit leader General Motors Europe saw its net cut in half, to around \$600 million. For a terrible moment, it looked as if all the dire predictions about the European industry's loss of competitiveness had come disastrously true.

This year, much to their own surprise, major companies are recovering. Car sales in Western Europe's huge market rose an estimated 5%, to 7.3 million units in the first seven months, confounding industry forecasts of a flat year. Volkswagen, Europe's biggest producer with its stable of VW, Audi, Skoda, and SEAT brands, returned to profits in the second quarter. And demand for Fiat models, such as its new Punto compacts, is so hot that plants usually

shuttered in August for vacations were working full tilt.

Is the uptick in profits a fluke—or the payoff to European auto makers for their massive makeover efforts in recent years? Industry leaders aren't popping champagne corks just yet. Unveil-

VW GOLF MODELS IN FRANCE: HEFTY REBATES



AS EUROPE'S AUTO MAKERS BOOST THEIR HORSEPOWER...

LEANER PAYROLLS Industry employment cut 20%, to less than 1 million workers since 1989.

HOT NEW MODELS Fiat's small Punto and Ford's Mondeo are selling fast. VW just unveiled a new subcompact Polo, and GM Europe is launching a Tigra sports coupe.

IMPROVED PRODUCTIVITY Each worker at Fiat's \$2.9 billion Melfi facility is expected to produce 79 cars a year, about the same as Japanese makers.

LOWER PARTS COSTS Major companies are getting price cuts of 15% or more from components suppliers, outsourcing parts engineering, and using more common parts.

FASTER DEVELOPMENT Peugeot-Citroën can now get a new car from drawing board to market in 3–3/4 years, down from 5 years at the end of the 1980s.

DATA: COMPANY REPORTS, BUSINESS WEEK

ing VW's new subcompact Polo in Paris on Aug. 22, CEO Ferdinand Piëch said incoming orders in July fell back to the same level as a year ago after an 8.5% rise in this year's first six months. This alarmed European stock markets, where carmakers have been strong performers this year: VW shares are up 9% far despite a 4.3% drop on Aug. 23, and Peugeot's 6% year-to-date rise contrasts with the Paris market's overall 11% decline.

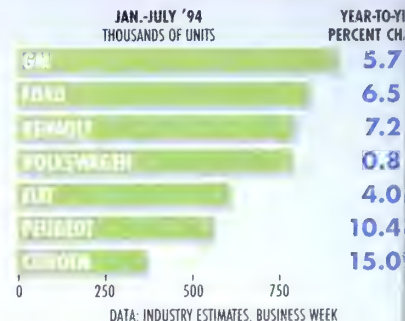
HARD CLIMB. There's no doubt, though, that the industry is leaner and meaner. By giving themselves a painful tune-up, Europe's companies have made substantial gains (table). Peugeot Chairman Jacques Calvet brags that his company's productivity grew 50% in the past five years. Industry payrolls have shrunk drastically: GM Europe, for example, has shed 6,600 workers, or over 7% of its labor force, since the end of 1990. And from Mercedes' C-Class to Fiat

Punto, both launched last year, new models are attractive and more aggressively priced than before.

Such basic strides, combined with Europe's economic recovery and temporary sales incentives in some countries, have started auto makers on what looks like a steady, arduous climb back to competitiveness. So far this year, they have enjoyed unexpected luck. The strong yen has blamed most Japanese rivals, though Honda's European sales are up. And car buyers are gaining confidence from reviving economies—with Germany's, for example, now expected officially to grow 2.5% this year.

The biggest boost, though, come from temporary measures in France, Spain, and Denmark to spur

...THEIR SALES ARE REBOUNDING



sales. Buyers who scrap old clunkers hefty rebates. The French government, for example, gives \$950 to owners junk 10-year-old cars and buy new. "The scrapping incentives," says Maher, auto analyst at consultants DRI Europe Ltd. in London, "opened those markets around." The tonnage has been most powerful for French and Spanish producers. Peugeot and Citroën sales, for instance, rose 10% and 12% in the first seven months of this year, respectively, while VW's Spanish subsidiary SEAT scored a nearly 20% gain. The incentives will be phased out by the end of 1995, but they have benefited car makers by advancing the cyclical pickup in European markets.

Spreading the rebound over two years is providing a welcome breather. "The more wrenching change is still to come. 'Most of the Europeans underestimate the effort involved' in regaining first-class competitiveness," says Susan Jacobs, chairman of Little Falls (N.J.) consultancy Jacobs Automotive. "It [Detroit's] Big Three a decade and a half ago tried to get it right."

CHERRY-COLORED. At least the effort is under way. Peugeot's Calvet, for example, is calling for another 50% gain in productivity in the coming five years. Renault expects to go on cutting its workforce by a steady 4% to 5% a year while already lopping off 29,000 jobs in 1995. "It's unavoidable, [if we want] to stay competitive," says Chairman Louis Schweitzer.

Italy's new \$2.9 billion plant, opened in January at Melfi in southern Italy, is another attempt at getting it right. It borrows heavily from Japanese ideas—built down to just-in-time suppliers located nearby and cherry-colored uniforms worn by everyone from assembly line operatives to plant bosses. The acid test will be whether it can hit its ambitious production goals. Its 5,700 production workers are supposed to build 100,000 cars annually—a rate of 79 cars per worker per year, compared with Japan's average of 78.

Overcoming their initial distaste for learning from Japan, European makers have narrowed the productivity gap. E. Ludvigsen, chairman of London-based auto consultants Ludvigsen Associates Ltd., figures Europe's best are now at 30% less efficient than the median Japanese producer, compared with 1990, five years ago. In 1999, the European Union will dismantle its final barriers against Japanese-made cars. The challenge for Europe's auto makers, in the race of their lives, is to pull level behind them.

by John Templeman in Bonn, with Robert Toy in Paris and Silvia Sansoni in Rome

PALESTINE: CLINTON MAY BE READY TO PUT CASH ON THE TABLE

The Administration hopes seed money will spur local development

Yassir Arafat, meet the friendly gray suits from the Overseas Private Investment Corp. They're from Washington, and they're coming to help you.

In a move designed to cement the year-old peace accord between Israel and the Palestine Liberation Organization, the Clinton Administration is getting ready to put money on the table. By summer's end, the Administration will announce a plan to spend \$125 million in risk insurance, loan guarantees, and direct loans to spur business invest-

ment. If initial projects succeed, however, OPIC officials predict that megadeals will follow in the next two years.

But for now, the Administration is concerned that Palestinians and Israelis are drawing away from each other. Privately, U.S. officials say the Israelis seem lukewarm about forming joint ventures with Palestinians in both the newly autonomous lands and the still-occupied territories. At the same time, emboldened Palestinian entrepreneurs want to strike out on their own. U.S. officials see the OPIC deals as seed money

to spur local economic development. That, they hope, will eventually entice Israelis and Palestinians to invest in joint ventures and pull in private funds from abroad. "Such investment creates opportunities for partnerships throughout the region," says OPIC President Ruth R. Harkin.

OPIC's ventures will launch small-scale projects designed for quick start-up. They include a Culligan International Co. joint venture to bottle



A STREET VENDOR: PALESTINE HAS TO START FROM SCRATCH

ment in the West Bank and Gaza. In early September, Vice-President Al Gore hopes to cap a Mideast tour with an announcement of the first four deals guaranteed by OPIC. A month later, OPIC and Builders for Peace, a private investment group, will ferry 15 Palestinian business executives on a five-city U.S. tour to drum up partners and venture capital.

MEGADEALS? The goal is to produce a fast payoff in a region that's getting impatient for the promised economic rewards of Middle East peace. "There has to be a quick, visible, material transformation in Palestinian lives through the development of the economy, jobs, housing, and all that flows from that," says a White House official.

Experts say OPIC's involvement is crucial given the continued instability in the region. "Unless there is a guarantee from somebody, you won't see large chunks invested," says Peter Gubser, president of American Near East Refu-

spring water for sale to tourists in Gaza; a West Bank furniture plant that will export to Eastern Europe; a construction company that will supply the housing industry; and a business hotel to house visiting venture capitalists. Other deals in the works include an olive oil processing plant and a company to market telephones. OPIC is also mulling an equity fund that small Palestinian companies could tap to launch startups.

Getting these modest ventures off the ground won't be a snap. Public services in Palestinian lands are all but nonexistent, roads are poor, and half of the population of 800,000 lives in shanties.

Still, revving up the economy stands out as the best hope for nurturing a fragile accord in territories that have known neither peace nor prosperity. The diplomats have done their part—now it's time for the bankers.

By Douglas Harbrecht and Amy Borrus in Washington

Bill Beizer
President



The long haul is nothing more than a series of short steps."

Planning your financial future doesn't have to be overwhelming. Just take a small amount of money to start, and invest it consistently. Over time, it can grow into a substantial nest egg,* which can help get your kids through college or let you plan toward your retirement. Whatever your financial goal, you can take a first step to realizing it by investing in a mutual fund. The Berger 100 Fund, a growth fund that invests in what we think are the best of the fastest-growing companies, could help you achieve your goals.

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investment plans do not guarantee a profit nor protect against loss in declining markets.)

To understand the impact of a regular savings plan in action, see the table below left. It shows how easily a hypothetical \$1,000 initial investment—with an additional \$50 invested each month—would have grown to \$79,182 over the past 19 years with the Berger 100 Fund. (Naturally, as with any mutual fund, past performance shows the fund's history and does not guarantee future results.)

A philosophy that resulted in significant success.

This kind of performance has grown out of a very practical philosophy that's guided us through nearly two decades of market fluctuations. That philosophy is simply to seek investments in profitable, successful companies because they are more apt to become profitable, successful investments. You can see from the chart below how well this philosophy has performed for us in the past.

"PUTTING IT IN" STEADILY IN THE BERGER 100 FUND

Hypothetical \$1,000 initial investment on 9/30/74 with \$50 invested at the end of each month. Note the market declines indicated in grey. To manage this kind of volatility in the market, we advise investing long term.

Date of investment	Annual investment (\$50 per month)	Value at end of year
9/30-12/31/74	\$1,150	\$1,285
12/31/75	\$600	\$1,863
12/31/76	\$600	\$2,892
12/31/77	\$600	\$3,571
12/31/78	\$600	\$4,611
12/31/79	\$600	\$6,693
12/31/80	\$600	\$9,779
12/31/81	\$600	\$10,212
12/31/82	\$600	\$12,256
12/31/83	\$600	\$14,897
12/31/84	\$600	\$12,479
12/31/85	\$600	\$16,341
12/31/86	\$600	\$20,225
12/31/87	\$600	\$23,969
12/31/88	\$600	\$24,986
12/31/89	\$600	\$37,750
12/31/90	\$600	\$36,249
12/31/91	\$600	\$69,238
12/31/92	\$600	\$75,823
12/31/93	\$600	\$92,567
6/30/94	\$300 YTD	\$79,182 YTD
Total Investments		\$12,850
Total Account		\$79,182

THE BERGER 100 FUND TOTAL ANNUAL RETURN FOR THE PERIOD ENDING 6/30/94

1 Year	3 Years	5 Years	10 Years	15 Years	19 1/2 Years ^{††}
-4.7% [†]	17.0%	19.5%	17.5%	15.8%	14.7%

[†]Source: Lipper Analytical Services, Inc.

^{††}Berger Associates assumed management of the Fund 9/30/74

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Figures in the charts represent past performance and do not guarantee future results. These performance figures include changes in share price and reinvestment of dividends and capital gains, which will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. The figures include the deduction of 12b-1 fees beginning in June 1990. *Dollar-cost averaging does not assure a profit and does not protect against loss in declining markets. Since the plan involves continuous investments in securities regardless of fluctuating price levels of securities, you should consider your ability to continue your purchases through periods of low price levels before investing.

THE SHERLOCK HOLMES OF ACCOUNTING

Howard Schilit is a powerful—and dreaded—financial gumshoe

By the look of things, business couldn't be better at Heilig-Meyers Co. After four years of acquisitions, the furniture and home-accessory retail chain has grown 46%, to 589 outlets. Last year, profits swelled 45%, to \$55 million, as sales rose 31%, to \$864 million.

Sound just a little too rosy? Howard M. Schilit certainly thinks so. After the American University accounting professor looked at Heilig's books recently, he was decidedly less upbeat. For starters, the company includes installment purchases in revenues before sales are final, says an Aug. 15 report Schilit wrote. More significant, its three years of steadily rising net income obscured rapidly growing cash-flow deficits. Last year, Heilig's negative cash flow totaled \$75 million. While emphasizing that Heilig's financial-reporting practices are perfectly legal, Schilit says "these aggressive accounting policies may distort the true financial condition" of the company.

Whether ferreting out instances of allegedly overstated revenues, as in Heilig's case, or showing how some companies can artificially depress current earnings to assure a big gain in subsequent years, Schilit is quickly earning a reputation as one of the top forensic accounting analysts in the country. He's one of a handful of front-line sleuths who are picking apart corporate earnings

reports in the wake of criticism that traditional outside auditors are falling down on the job of stopping misleading—or downright fraudulent—accounting practices.

As head of his own part-time consulting firm, the Center for Financial Research & Analysis, Schilit boasts a client list that includes some of the biggest money managers in the country, such as Fidelity Investments, Teachers Insurance & Annuity Assn.-College Retirement Equities Fund and The Portfolio Group of Chemical Bank, as well as the Council of Institutional Investors.

OVERZEALOUS? Equally long is the list of Schilit critics who lambaste the mild-mannered professor for what they see as his overzealousness or misinterpretation of accounting rules. "The whole report is completely erroneous and full of inaccuracies," fumes Heilig Treasurer Roy B. Goodman. He argues that accounting rules support the company's interpretation of when to book installment revenues. As for the negative cash flow, Goodman says "it simply reflects the rapid expansion of a high-growth company." Irwin S. Cohen of Deloitte & Touche, Heilig's outside auditors, dismisses Schilit's analysis as "off-base."

Heilig's managers aren't the only ones angry at Schilit. He has studied the financials of 39 companies over the past year. The result: 24 companies on which

he wrote negative reports have seen their stock dragged down by an average of 31%. Critics charge that even an unbiased analysis can send stock prices plummeting, spark investigations, and trigger costly lawsuits (page 52).

Schilit's specialty is flagging the frequent—and perfectly legal—gambit "window dressing," which puffs up profits and revenues. He is not alleging fraud; indeed, the accounting techniques he highlights are allowed under generally accepted accounting principles (GAAP). But GAAP rules are subject to wide interpretation—and companies have great leeway in choosing how conservatively or aggressively they account for financial transactions. Schilit's aim is to

QUESTIONING THE NUMBERS



Company	CHECKERS	HEILIG-MEYERS
Business	Franchises and operates fast-food restaurants	Furniture and home-accessory chain
Revenues	\$189.5 million, up 80%	\$864 million, up 31%*
Earnings	\$15 million, up 21%	\$55 million, up 45%
Stock price	5 1/8, down 57% since Schilit's Feb. 14 report	24 1/2, down 5% since Schilit's Aug. 11 report
Schilit's analysis	When selling restaurants to franchisees, Checkers books sale price as revenue immediately, before the sale is completed. Highly favorable accounting for acquisitions allows overly rapid consolidation of earnings.	Company books installment purchases as revenues before sales are final. Despite rising income, Heilig has negative cash flow that totaled \$75 million last year.
Company response	Company follows generally accepted accounting practices in all transactions.	Company says accounting standards support interpretation of when sales are final. It also says that negative cash flow reflects aggressive expansion and cost of building new stores.

*Fiscal year ended Feb. 28

DATA: CENTER FOR FINANCIAL RESEARCH & ANALYSIS, COMPANY REPORTS, BUSINESS WEEK



SCHILIT HAS
PRODUCED
NEGATIVE
REPORTS THAT
HAVE HELPED
DRAG DOWN
THE STOCK OF
24 COMPANIES
BY AN AVERAGE
OF 31%. CRITICS
CHARGE THAT
EVEN AN OFF-
BASE ANALYSIS
CAN SEND A
STOCK PRICE
PLUNGING

ke sure investors know how solid the
nbers in company accounts really are.
Schilit became well known when he
ured in the stunning fall of supercom-
er maker Kendall Square Research
rp. After going public in early 1992,
ndall's shares more than doubled, to
2, within a year, as revenues soared
m \$904,000 to \$20.7 million. Suspi-
us of that growth, Fidelity hired Schil-
o look at the company. In a Septem-
r, 1993, report, Schilit argued that
ndall was booking sales for which no
h was coming in. Kendall's auditor,
ce Waterhouse, subsequently discov-
ed that Kendall was claiming revenue
m computer sales to universities that
d not paid for the equipment. Price

Waterhouse revised 1992 revenues down-
ward to \$10 million, and said that a loss
of \$12.7 million should have been \$21.6
million. For 1993, Kendall reported a
net loss of \$67 million on revenues of \$18
million, and its stock was delisted by
NASDAQ after falling to 2% in April.

By uncovering such cases, their sup-
porters say, Schilit and other forensic
accountants are a needed counterweight
to the securities analysts, auditors, and
short-sellers who may have financial con-
flicts of interest that influence their re-
ports. "His value to me is fleshing out
the mismatch between reality and ac-
counting," says Schilit client Abraham
Bronchtein, research director at Chemi-
cal Bank's portfolio management unit.

FINANCIAL FERRETS. Some experts fear
the financial fudging will increase, as
shaky companies that went public during
the recent stock market boom try to
prop up high share prices. They may
be tempted "to contrive transactions to
increase income or take out expenses,"
says Abraham J. Briloff, an accounting
professor at City University of New
York's Bernard M. Baruch College.

Briloff and other critics of the ac-
counting profession say investors can't
always depend on independent auditors
to ferret out such practices. With the
Big Six depending more on management
consulting services for income, some ex-
perts fear that the firms are unwilling to
sacrifice the consulting business to go to
the mat over accounting issues.

Often, securities analysts aren't much

help either. Dallas-based David
Tice, who publishes the news-
letter *Behind the Numbers*,
notes that it's rare to get
downbeat analyses or "sell"
recommendations from equity
analysts. "The purpose of most
Wall Street research is sup-
porting the firm's underwrit-
ing business," says Michael
Murphy, publisher of the *Over-
priced Stock Service*, a news-
letter for short-sellers.

Of course, investors have to
be equally wary of short-sell-
ers' incentives for trashing a
stock. It's just that battle of
conflicting agendas that has
left a lucrative niche for inde-
pendent gumshoes such as the
42-year-old Schilit, who doesn't
invest in or make recommen-
dations on the stocks he
writes up.

RED FLAGS. Schilit's method for
targeting companies is less
than scientific. He scours pub-
lished lists of hot-growth com-
panies, looking for companies
whose stock prices have trip-
led in 18 months. Last winter,

Pyxis Corp., a San Diego outfit that
makes and leases automated systems
for distributing medications, piqued his
interest after its stock soared from \$10
to \$37 in less than two years. His Mar. 3
report concluded that the sharp rise in
revenues—from \$13.4 million to \$100 mil-
lion—that Pyxis had reported over the
past three years was "misleading" and
"unsustainable." Just before going public
in 1992, Pyxis started booking revenues
from equipment leases as if they were
outright sales, rather than spreading
them over the life of the lease, Schilit
says. Although permitted by accounting
rules, he says the practice "exaggerates
the growth in sales and earnings."

Reaction was swift. Pyxis' stock price
fell to \$20 by late April. Four share-
holder lawsuits were filed, although they
were eventually dropped when no evi-
dence of fraud was found. "The report
was not responsible; it contains several
factual errors," says Nadine Padillo, in-
vestor relations officer for Pyxis. A let-
ter from auditor Ernst & Young defend-
ing the practice was printed as an ad in
Investor's Daily. "There is no acceptable
alternative," the firm declared.

Schilit also looks for financial-state-
ment chicanery at companies where
there are management red flags: boards
packed with people who have ties to the
company, questionable compensation ar-
rangements, and insider stock sales be-
fore bad news. One example of a compa-
ny whose management practices gave
Schilit cause for concern: Checkers

data provider, oil and gas explorer

lion, up 50%

llion, up 26%

11% since Schilit's May 24 report

ny books cost of all exploration
s as an asset. Has not established
at allowance for doubtful accounts.

ners don't pay bills, earnings and
s will have been overstated.

izing all exploration costs is an
ble accounting method for oil
ies and is approved by the SEC and
Company has no need for larger
ns as bad debts have been minor.

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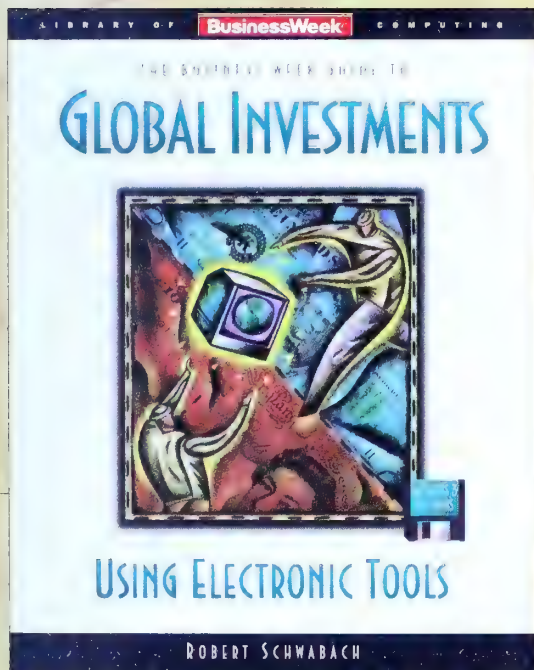
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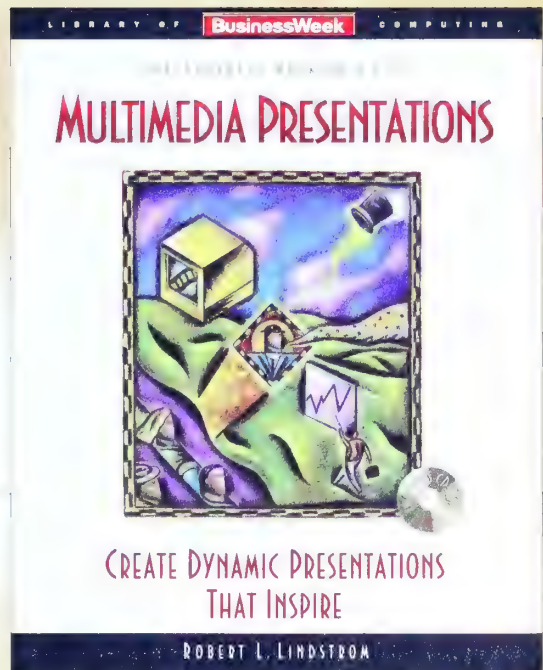
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The Corporation

Drive-In Restaurants Inc. in Clearwater, Fla. His Feb. 14 report noted that Chairman Herbert G. Brown named two sons, both in their 20s, as executive vice-presidents, and it claimed that the board has no truly independent outsiders.

In looking at Checkers' books, Schilit found examples of aggressive accounting in 1993 that he alleges hid the company's deteriorating condition. Checkers' rapid earnings growth came to a halt in 1994's first half, as the company posted a \$500,000 loss, compared with \$7.8 million in profit for the first half of 1993.

POOL HAULS. Schilit points out that when Checkers sells its modular restaurant kits to franchisees, it books the full sale price as revenue during construction, before the sale is completed. He also criticizes Checkers for making frequent acquisitions with stock and accounting for them by a favorable method known as "interest pooling." The result, he says, is that Checkers' own earnings could have received a deceptively large boost from consolidating earnings from acquired restaurants.

Checkers officials reject the criticism. "Our accounting methods are dictated by generally accepted accounting practices and have been approved by the SEC and our outside accountants," says one. KPMG Peat Marwick, Checkers' auditors, declined comment. The company's stock, at 5%, is down 57% since December 1993, following Schilit's report and a shareholder suit alleging securities fraud.

Schilit's reports don't always precipitate a stock drop. The share price of Seitel Inc. has increased 11%, to 31%, since it was the target of a critical report in May. The Houston seismic-data company got a boost from good drilling news in its recently started oil-and-gas-exploration business. But that hasn't changed Schilit's opinion. He complains in his July report that Seitel books all the costs of gathering its seismic data as assets rather than charging some as expenses. That could overstate earnings and net worth. He also thinks revenues could suffer because Seitel understates the risk of nonpaying accounts. "Time will tell if I'm right," he says.

Seitel replies that Schilit's complaints smack of overzealousness. Debra D. Valice, Seitel's chief financial officer, says that "capitalizing exploration costs is an acceptable practice in the oil-and-gas industry." The company's accounting methods have won approval from Arthur Andersen & Co., its outside accountants, as well as the IRS and the SEC. Moreover, Valice says Seitel has no need to increase provisions for bad debts, because the company suffers only minor write-offs. "It's unfair to criticize companies

for using accounting methods that are allowed by the rules," says Philip D. Wemeyer of Arthur Andersen.

Still, major energy companies don't typically capitalize 100% of exploration costs. The dispute highlights how unscientific accounting can be. In an effort to make reporting more precise, an advisory committee to the American Institute of Certified Public Accountants has rec-

ommended instituting stiffer disclosure requirements by yearend 1995. But the move is strongly opposed by the Business Roundtable and the Conference Board. Whatever the rules, many accountants say there are limits on what they can do. As long as companies can find accounting loopholes to exploit, sleuths like Schilit will have a field day.

By Michael Schroeder in Washington

THE BIG SIX REACH FOR A BIG SHIELD

Washington has been consumed this summer by health-care reform and crime legislation. But for some companies, securities-law reform has generated far more interest. Frustrated at the skyrocketing cost of what they consider frivolous shareholder lawsuits, the Big Six accounting firms are pushing for legislation to limit the right of investors to sue for securities fraud.

Proponents highlight the benefits of reform for growth companies, which say they are often hit with nuisance suits when bad news sends stock prices tumbling. But accountants stand to gain most. Under two bills now before Congress, shareholders would no longer be able to recoup 100% of damages from auditors if the accountants played only a minor role in the fraud (table). That would be a major change in existing law, which has saddled the Big Six with \$1.4 billion in fines, settlements, and jury verdicts since 1991.

The legislation would limit accounting firms' liability to a proportional share of damages. The current system encourages shareholders to aim for the wealthy firms, particularly if a guilty company has gone out of business.



PUTTING THE BRAKES ON SUITS

Pending legislation would limit the rights of shareholders to sue for securities fraud. Among the provisions:

- ▶ To discourage dubious cases, losers would have to pay all legal fees.
- ▶ Named plaintiffs in securities-fraud suits must own at least \$10,000 of stock or 1% of company's securities.
- ▶ Defendants would be responsible for only a proportional share of damages they cause. Currently, each defendant can be held liable for 100% of the damages assessed against all defendants.

DATA: BUSINESS WEEK

free rein to financial wrongdoers," says Craig A. Goettsch, president of the North American Securities Administrators Assn.

With Congress still embroiled in crime and health-care issues, lawmakers may not have time to act on the legislation this year. But shareholder lawsuits won't go away. And neither will the legislative drive to curb them.

By Michael Schroeder in Washington



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Dear Nabisco All-Star Legends Collector: As a participant in last year's offer, you are being given a sneak preview of our 1994 All-Star Legends cards. Be the first on your block to order these special limited-edition cards....

Does it seem as if a lot of companies are taking quite a friendly interest in your life these days? Helping you mark your birthday? Soothing your homesickness? Giving you an early peek at something new? If this kind of stuff is turning up in your mailbox more often, you're not alone. You're on the receiving end of a sophisticated, high-tech twist to the ancient art of persuasion. It goes by different names—database marketing, relationship marketing, one-to-one marketing. But it all adds up to the same thing: Companies are collecting mountains of information about you, crunching it to predict how likely you are to buy a product, and using that knowledge to craft a marketing message precisely calibrated to get you to do so.

It amounts to one of the biggest changes in marketing since "new and improved." First came the mass market, that vast, undifferentiated body of consumers who received identical, mass-produced products and messages—any color of car they wanted, so long as it was black. Then came market segmentation, which divided still-anonymous consumers into smaller groups with common demographic or psychographic characteristics. Now, new generations of faster, more powerful computers are enabling marketers to zero in on ever-smaller niches of the population, ultimately aiming for the smallest con-

HOW IT WORKS

1 THE PRODUCT



2 INTO THE DATABASE MAW

You may think you're just sending in a coupon, filling out a warranty card, or entering a sweepstakes. But to a marketer, you're also volunteering information about yourself—data that gets fed into a computer, where it's combined with more information from public records.

3 DIGESTING THE DATA

Using sophisticated statistical techniques, the computer merges different sets of data into a coherent, consolidated database. Then, with powerful software, brand managers can "drill down" into the data to any level of detail they require.



4 AN IDEAL CONSUMER

The computer identifies a model consumer of a chosen product based on the common characteristics of high-volume users. Next, clusters of consumers who share characteristics—interests, incomes, brand loyalties, for instance—can be identified as targets for marketing.

MARKETING

7 REFINING THE DATABASE

The database is continually updated with information collected from product-oriented clubs, responses to coupons, calls to 800 numbers, and sweepstakes entries, as well as with new lists from outside sources.



6 SHARING DATA WITH RETAILERS

Cash-register scanners provide reams of information about exactly what shoppers are buying at specific stores. Merged with the manufacturer's data, this intelligence helps to plan local promotional mailings, fine-tune shelf displays, and design store layouts.

5 USING THE KNOWLEDGE

The data can be used in many ways: to determine the values of coupons and who should get them; to develop new products and ensure that the appropriate consumers know about them; to tailor ad messages and aim them at the right audience.



sumer segment of all: the individual.

A growing number of marketers are investing millions of dollars to build databases that enable them to figure out who their customers are and what it takes to secure their loyalty. Direct marketers have long been in the vanguard of database users: Catalogs, record clubs, and credit-card companies have always needed their customers' names and addresses to do business with them. But database marketing is now moving into the marketing mainstream, as everyone from packaged-goods companies to auto makers comes to believe that in the fragmented, fiercely competitive marketplace of the 1990s, nothing is more powerful than knowledge about customers' individual practices and preferences.

HOG-TIED. In 1992, for example, General Motors Corp. joined with MasterCard to offer the GM Card. As a result, GM now has a database of 12 million GM cardholders, and it surveys them to learn what they're driving, when they next plan to buy a car or truck, and what kind of vehicle they would like. Then, if a cardholder expresses an interest in, say, sport-utility vehicles, the card unit mails out information on its truck line and passes the cardholder's name along to the appropriate division.

Blockbuster Entertainment Corp. is using its database of 36 million households and 2 million daily transactions to help its video-rental customers select movies and steer them to other Blockbuster subsidiaries. In Richmond, Va., the company is testing a computerized system that recommends 10 movie titles based on a customer's prior rentals. The suggestions are printed on a card that also offers targeted promotions. Customers who have rented children's films, for example, might get a discount at Discovery Zone, Blockbuster's play-center subsidiary.

Kraft General Foods Inc. has amassed a list of more than 30 million users of its products who have provided their names when sending in coupons or responding to some other KGF pro-

DATA: BUSINESS WEEK, COOPERS & LYBRAND CONSULTING

motion. Based on the interests they've expressed in surveys, it regularly sends them tips on such things as nutrition and exercise—as well as recipes and coupons for specific brands. The company figures that the more information consumers have about a product, the likelier they'll be to use more of it (sample tip: Use Miracle Whip instead of butter for grilling sandwiches). KGF constantly refines its database by sending surveys to the names on its list.

Like KGF, Harley-Davidson Inc. wants

RJR have assembled huge databases of smokers they can reach directly. For example, by requiring consumers who respond to offers of free shirts, sleeping bags, or other merchandise to fill out detailed questionnaires, Philip Morris has built a list of some 26 million smokers' names and addresses. The companies use their lists both to market to smokers with coupons and promotions and to enlist grassroots support for their lobbying efforts.

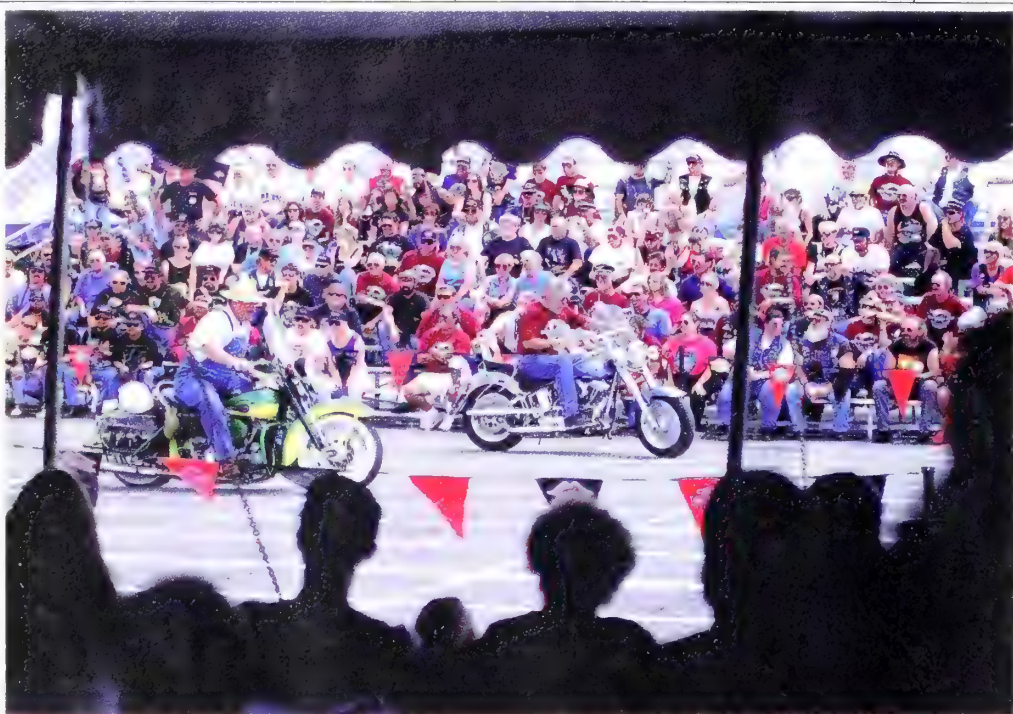
Consumers appear to be responding

Why all the activity? In part, it's the name of the relentless drive to make marketing more efficient. Seagram knows that most U.S. adults aren't likely prospects for its distilled spirits: Two thirds of them haven't had a single drink of liquor in the past 30 days. As a result, notes Richard P. Shaw, vice-president for marketing communications, Seagram, mass-market advertising has a great deal of what we would call nonproductive reach." Of course, many conventional promotions, and much typical junk

mail, are similarly wasted because they're aimed at too broad an audience. "We're trying to kill off junk mail, junk mail defined as 'anything I didn't ask for and wouldn't be interested in,'" says Barrington I. Hill, London-based senior vice-president for product development at American Express Travel Related Services Co., which has been using its detailed database to send carefully aimed promotions to cardholders.

SIMULACRUM. Marketers increasingly are recognizing that past customer behavior, as recorded in actual business transactions, is by far the best indicator of future buying patterns. "It's not true that demographics is destiny," says Matt Kuckuk, senior principal at American Management Systems Inc.'s Financial Industry Group. Merely knowing Mr. Jones's Social Security Code or income generally yields less insight—and opportunity—than knowing, say, that he has just applied for his first joint checking account. That probably signals a marriage, which means future openings to sell a mortgage, life insurance, long-term

investments, perhaps even a college loan. It's a kind of cybernetic intimacy: ever-expanding processing power, marketers see an opportunity to close the gap that has widened between companies and their customers with the rise of mass markets, mass media, and mass merchants. Database marketing, they believe, can create a silicon simulacrum of the old-fashioned relationship people used to have with the corner grocer, butcher, or baker. "A database is sort of a collective memory," says Richard G. Barlow, president of Frequency Marketing Inc., Cincinnati-based consulting firm. "It deals with you in the same personalized way as a mom-and-pop grocery store, while



to urge customers to keep using its products. That's why it mails the 256,000 members of its Harley Owners Group (HOG) a bimonthly magazine packed with listings of regional, national, and international events to encourage owners to get out on the road and use their bikes. House of Seagram uses its 10 million-name database for loyalty-building programs for existing products. It might send premiums tied to proofs of purchase—a pair of snifters, say, to someone who bought its Martell cognac. Seagram uses surveys to identify likely buyers of new products, as well as drinkers of rival brands it can send offers to. RJR Nabisco Holdings Corp. is building a database that identifies, among other things, households that have responded to past promotions.

Over on the tobacco side of RJR Nabisco's business, database marketing has long been practiced in earnest. For cigarette makers, it's a virtue born of necessity. Facing increasing restrictions on advertising, Philip Morris Cos. and

to the precision marketing. But of course, this private intelligence-gathering gives some people the creeps. At best, critics say, targeted marketing efforts are intrusive and annoying. At worst, the collection, manipulation, and combination of lists of personal information amount to an ominous invasion of privacy (page 60). Such concerns aren't fazing the marketing types, though. According to Donnelley Marketing Inc.'s annual survey of promotional practices, 56% of manufacturers and retailers are currently building a database, an additional 10% plan to do so, and 85% believe they'll need database marketing to be competitive past the year 2000. "It is one of the most important marketing developments of the 1990s," says marketing guru Stan Rapp, chairman of consultants Cross Rapp Associates.

BIKE BONDING

Harley-Davidson's owners group keeps members involved with a magazine and rallies

knew customers by
and stocked what
wanted."
consider the dilemma
busy casino. In the
days, the pit boss
notebooks on fre-
t players. Periodi-
he would pick a
from the notebook,
the high roller up,
offer a free room for
weekend. Today,
thousands of visi-
trooping through on
given day, "it's virtu-
impossible to get to
people on a first-
basis," says Rob-
M. Renneisen Jr.,
of Claridge Hotel &
Corp.

ow, the casino's com-
keeps tabs on visi-
who use its fre-
t-gamblers' card and
s out offers every
Claridge's Com-
Gold, which offers
unts and tips on upcoming events,
350,000 active members. They get
s ranging from \$10 in coins for slot
ines to monogrammed bathrobes
door-to-door limo service. "It's made
ore efficient," says Renneisen. "We
arget our dollars directly to custom-
who justify the costs."

WATER VALUE. In addition, by weav-
relationships with its customers, a
pany can make it inconvenient for
umers to switch to a competitor.
Peppers, co-author of *The One to*
Future, one of the bibles of the
marketing, cites MCI Communica-
s Corp.'s Friends & Family long-
ance discount plan. To get the dis-
it, the customer has to form a
ork of friends and family mem-
—"a substantial investment in time
energy on the consumer's part,"
notes. Changing long-distance cars
means having to "reinvent my re-
ship," Peppers says.

all these efforts to forge ties to con-



sumers are based on the
same fundamental idea:
There's no more impor-
tant asset than a happy
customer. Happy custom-
ers remain customers,
and it's much cheaper to
keep existing customers
than to find new ones.

Michael D. Keefe, director of Harley-
Davidson's HOG, is reluctant even to call
the process marketing. "It's more like
customer bonding," he says. "If people
use the motorcycle, they'll stay involved.
If there's nowhere to ride, no place to
go, the motorcycle stays in the garage,
the battery goes dead, and a year from
now, they just sell it."

Some database marketers say their
promotional offers garner response
rates in double digits, considerably
higher than the typical 2% to 4% for
junk mail. For example, the targeted
promotions that Hilton Hotels Corp. of-
fers senior citizens in its Senior Honors

TASTY TIDBITS

Kraft sends coupons and
nutrition tips to 30 million
customers, such as this
recipe contestant

frequent-traveler pro-
gram, which features
discounts and travel
tips, have persuaded
close to half of the
club's members to take
previously unplanned
trips that included stays
at Hilton hotels. And
KGF says its offers to
those listed on its data-
base get significantly
higher response rates
than standard mass-
market coupons. The
database, says John T.
Kuendig, vice-president
for market develop-
ment, is a list of steady
consumers who "have a
greater value to the
brand."

NO CHOICE. Database
marketing has its skep-
tics, of course. An ear-
lier flush of enthusiasm
prompted by the spread
of checkout scanners in
the 1980s ended in wide-
spread disappointment:
Many companies were
too overwhelmed by the
sheer quantity of data
to do anything useful
with the information.
And some critics say
these efforts to reach
out and touch individual

customers haven't demonstrated their
usefulness in many product categories.
Programs that identify frequent custom-
ers and reward them may make sense
for airlines, but consumers have rejected
the "frequent-eater" programs offered
by some fast-food chains as being not
worth the bother.

Still, many companies believe they
have no choice but to brave the data-
base-marketing frontier. For one thing,
most manufacturers are waging an in-
formation war with the retailers that
stock their products. Large supermar-
ket chains and giant mass merchandis-
ers, such as Wal-Mart Stores Inc., have

PIONEERS OF THE NEW MARKETING

sampling of database-marketing
programs:

AMERICAN EXPRESS Using massively
parallel processors, it's sorting through
individual cardmembers' transactions
and basing promotions on what it learns.

PHILIP MORRIS PM's Marlboro Adven-
ture, a promotion for Marlboro smokers,
distributed more than 30 million pieces

of merchandise to smokers—and helped
build a 26 million-name database it uses
for direct marketing and lobbying.

HOUSE OF SEAGRAM Uses list of 10 mil-
lion adults who drink spirits to launch
new products, build brand loyalty, and
take aim at drinkers of rivals' products.

GENERAL MOTORS GM regularly surveys
its 12 million credit-card holders on

whether they expect to be in the market
for a car or truck soon, what kind of
models they're interested in, and whether
they would like information on vehicles.
These leads are passed on to GM's mar-
keting divisions.

BLOCKBUSTER ENTERTAINMENT Using
records for 36 million households, it's
testing a system that will recommend mo-
vies based on a customer's past rentals.

grown increasingly sophisticated in their use of checkout-scanner data to keep track of sales. They now base many of their choices about what to stock, what to promote, and what to charge on that information. To shape those decisions to their advantage, manufacturers need persuasive information of their own. "To the extent we have built up relationships with our consumers and know which ones will respond, we can work with retailers to help them build their businesses," says KGF's Kuendig.

BUSYBODY QUESTIONS. Databases start with information from the consumer. In transactional businesses, such as charge cards, banking, or catalogs, that's easy: The marketer simply collects information on the sale. For other marketers, the challenge is to get consumers to volunteer the data about themselves. Many packaged-goods marketers collect information that consumers divulge when they call 800 numbers or mail in coupons. In its surveys, Seagram tracks consumers' names and addresses, the brands and types of alcohol they drink, their sex, birthdate, income, and how many bottles they purchase in an average month. And GM went into the credit-card business not just to build loyalty and offer cardholders rebates on cars but also because it saw the billing process as a way to

harvest reams of data about consumers. "This is a gold mine," says H. D. "Hank" Weed, general marketing manager for the GM Card.

Having assembled a list of consumers, the marketer then mixes in information from other sources. Research houses such as Donnelley, Metromail, and R. L. Polk glean vast amounts of data from public records—drivers' licenses, auto registrations, and mortgage-tax rolls. Even income, the most sensitive subject, can be estimated based on mortgages and automobile registrations. Such information isn't cheap, though. This year, for instance, Ohio sold its drivers' license and car-registration lists to TRW Inc. for \$375,000.

Wittingly or unwittingly, consumers often offer plenty of data about themselves. Think of all those busybody questions on a warranty card: What's your age, income, occupation, education, and marital status? How many children? Do you hunt, fish, or play tennis? If you think none of that has much to do with the guarantee on that radio you just bought, you're right. But National Demographics & Lifestyles Inc., based in Denver, collects those warranty cards and the precious information they reveal, then resells it to database marketers.

Increasingly, the computer itself is sifting through such data for patterns that will predict behavior. Using neu-

ral-network software, computers c plow through masses of data and determine how specified variables may depend on one another (page 62). For example, what combination of income level, investment activity, and credit-card spending is most likely to be seen among people who are in the market for mortgages? Once the network comes up with a highly specific profile of some class of customer, it's easier to find new customers matching that profile and aim at them with customized direct-marketing schemes.

Most marketers consider the greatest benefit of the databases simply to identifying who their current customers are and how much business the company is doing with them. First Commerce Corp., a \$6.4 billion New Orleans banking holding company with five banks, has been using this technology to retain current customers and build its business. Its customers, like those at every bank, tend to bank with several institutions. But by analyzing the data available on its current checking customers, First Commerce can try to win more of them as credit-card customers, too. The work is done with a combination of PCs and mainframe storing hundreds of thousands of records. On a fast PC, a new network run can take from 30 to 60 minutes to complete.

Where there are millions of records

YOU CAN RUN, BUT IT'S TOUGH TO HIDE FROM MARKETERS

For years, Lisa Tomaino kept her address secret. She and her husband Jim, a policeman, wanted to make it as hard as possible for the crooks he had put away to find out where they lived.

But last year, Lisa had a baby. So much for her big secret. Within six weeks, she was inundated with junk mail aimed at new mothers. The hospital had sold her name and address to a direct-marketing company, and soon she was on dozens of other lists. Efforts to get off them proved fruitless. "It was a complete violation of our right to privacy," she declares.

Private citizens, privacy watchdogs, and a handful of lawmakers have railed for years about Big Brotherism by business. But when politicians balance industry's interest in reaching markets against the customers' right to privacy,

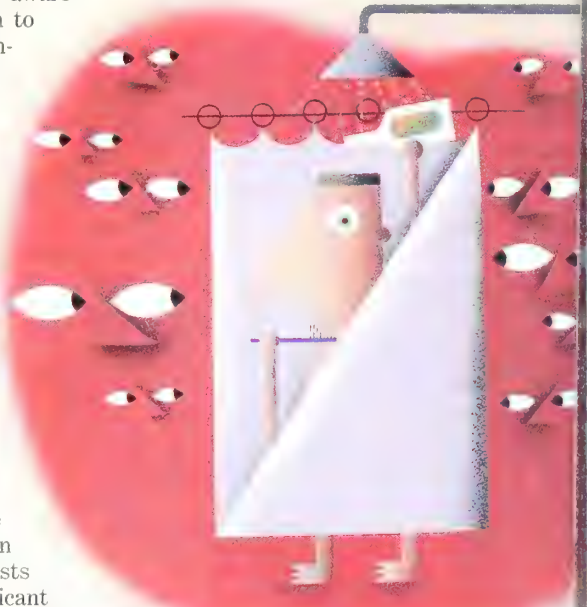
marketing usually wins. "Existing laws regulating privacy simply aren't effective," gripes Robert S. Bulmash, president of Private Citizen Inc., a public advocacy group in Naperville, Ill.

Marketers are keenly aware of the public's reaction to their unwanted attention. After all, it's their job to stay in touch with the preferences of consumers. "People worry about what we know about them and how we're going to use it, and that's legitimate," says Richard Barton, a senior vice-president for the Direct Marketing Assn. (DMA) a Washington-based trade group.

But vendors of marketing data argue that any intrusion on privacy from selling lists is offset "by the significant potential gain to consumers

from the special offers and promoted by direct marketers," says Gambill, president of Trans Union, a Chicago-based credit bureau.

The industry has



ft through, so-called
sively parallel data-
computers, at typi-
prices of \$1 million
more, may be re-
ed. These machines
t together scores or
a hundreds of the
est microprocessors
nd, giving them the
ph to respond in
utes to complex
base queries. Mar-
rs call these com-
searches "drilling
With such speed
and, companies can
ch their databases
e frequently and feel
to experiment with
strategies. "Before
l computing, you

didn't have the juice required," says
g Cheney, director of program de-
pment at AT&T Global Information
tions, the former NCR Corp. and a
er of parallel database computers.
OTHER REPORTS. Massively parallel
essors from Thinking Machines Inc.
a key technology for American Ex-
s Co. Before the systems were in
e, the amount of information the
pany could keep on each cardmem-
was limited to basic stuff, such as
cardmember's name and address,
long he or she had been a card-
er, and how much the cardmember



had spent in the past
year. With massively par-
allel processing, AmEx
could vastly expand the
profile of every custom-
er. "We basically store
every transaction," says
product-development ex-
ecutive Hill.

Now, 70 workstations at the Ameri-
can Express Decision Sciences center in
Phoenix race through mountains of data
on millions of AmEx cardmembers—the
stores they shop in, the places they
travel to, the restaurants they've eaten

CASINO LOYALE

Claridge offers special
discounts and services to
its CompCard Gold
frequent gamblers

ff regulation by convincing the
government that it can police it-
DMA, for example, runs a phone
or people who want their names
from mailing lists. But relative-
consumers use it, and those who
nd that their names come off
ot all, lists. "It's really mean-
says Evan Hendricks, editor of
Times. "It's just a public rela-
ort."

akers are now mulling a measure
nd limit the ability of state motor
departments to give out informa-
at licensed drivers. Senator Bar-
er (D-Calif.) sponsored the Sen-
ion after a deranged man used
a driver records to track down a
y actress, whom he killed.

FOR STATES. The proposed curbs
of the controversial crime bill,
as resuscitated in the House and
e Senate in late August. But the
ons would have limited impact.
ates objected to a ban on the re-
driver information, arguing that
ed the revenue from the sale of
e whittled-down bill now enables
s to opt out of having their
old. Consumer advocates complain

that such provisions don't work because
most are written in tiny type.

Longstanding laws, such as the 1970
Fair Credit Reporting Act, aren't much
better, according to privacy experts. The
statute is supposed to prevent credit
agencies such as TRW, Equifax, and Trans
Union from releasing financial informa-
tion about a person except for "legiti-
mate" business needs, such as a credit
check.

Legitimate needs, however, have never
been clearly defined. In a January, 1993,
decision against Trans Union, a Federal
Trade Commission administrative law
judge ruled that the law bars the use of
credit information to develop mailing lists.
In response, TRW Inc. stopped using its
credit data to develop lists, but it still
sells lists based on demographic informa-
tion it collects. And Trans Union has cho-
sen to fight the ruling.

As marketing techniques become more
sophisticated, the privacy of the Lisa To-
mainos of the world will grow increas-
ingly difficult to protect. And marketers
will do everything they can to make sure
remaining anonymous doesn't get any
easier.

By Mark Lewyn in Washington

in, and even the eco-
nomic conditions and
weather in the areas
where they live.

Every month for a
little more than a year,
AmEx has been using
that information to send
out precisely aimed of-
fers. They go out in mil-
lions of customized
monthly bills that the
company says amount
to individualized news-
letters sent to a grow-
ing number of custom-
ers around the world.
On one British card-
member's recent state-
ment, a British Airways
flight triggered an offer,
printed adjacent to the
transaction, of special
deals on weekend get-
aways to New York and
continental Europe. A
purchase at Harrod's
triggered a notice of a
special sale at the store
for AmEx cardholders.
Since its introduction in

Ireland in March, 1993, this "relation-
ship billing" has been rolled out through
Europe, Canada, and Mexico. AmEx
has seen an increase of 15% to 20% in
year-over-year cardmember spending
in Europe and gives the new billing
format much of the credit. Next year,
AmEx plans to introduce relationship
billing in its biggest market, the U.S.

Heavy computing firepower isn't al-
ways necessary, though. For some ef-
forts, all it may take is a few thousand
dollars' worth of hardware and software.
Using a Macintosh personal computer,
Yuri Radzievsky has built a database of
Russian, Polish, and Israeli immigrants
to the U.S. By combing lists of sub-
scriptions to foreign-language newspa-
pers and buyers of tickets to events
such as tours by Russian entertainers,
his YAR Communications has assembled
lists of 50,000 Russians, 75,000 Poles,
and 30,000 Israelis in the U.S. Such in-
formation is of real value to client
AT&T—telephone service, after all, is one
of the first things new arrivals want
when they set up their households.

Using the lists, AT&T has mailed He-
brew- and Russian-language offers of dis-
counts on calls home. "Every marketer's
dream is to be able to target those little
slices," says Sandra K. Shellenberger,
district manager of diversified marketers
and multicultural marketing communica-
tions for AT&T. Response rates for such
database-directed offers sometimes run
as high as 20% to 30%, she says, com-
pared with the low single digits for

broad, more conventional direct mail.

Where will it all end? Few predict that database marketing will supplant mass marketing. Still, many targeted direct-mail campaigns are as glossy as any big-budget ad campaign. The mailings Seagram sends out feature lush photos and long, story-spinning blocks of copy discussing such matters as the proper way to drink single-malt scotch. Seagram also plans to rely heavily on database marketing to penetrate emerging markets, such as India and Thai-

land, where the proportion of affluent drinkers is so small that the use of mass media would be especially wasteful.

There's no doubt technology is shaking up traditional marketing methods. Marketers, after all, have been accustomed to thinking in broad swaths, such as adults 18 to 34 or women 25 to 49. Now, a typical AmEx segment might be business travelers who have bought jewelry abroad in the past month. Some of the offers the company has sent out in bills have gone to as few as

20 people. Says Hill: "This is a strange experience for the marketing people."

Can a faceless, distant marketer really create the personal relationships consumers used to have with the people they did business with? More and more companies are betting that the answer is yes as they reach out to envelop customers in an automated embrace.

By Jonathan Berry, with John Verity in New York, Kathleen Kerwin in Detroit, Gail DeGeorge in Miami, and bureau reports

SILICON AND SOFTWARE THAT MINE FOR GOLD

Marketing companies have long used computers to sift through reams of supermarket scanner data, merge and purge mailing lists, and analyze market research reports. But now, ultracheap computing power and new software are making the process much more precise.

Gathering data isn't all that difficult: Point-of-sale terminals, teller machines, and 1-800 telemarketing all contribute to the flood. The big challenge lies in making sense of what's collected, rather than throwing most of it away. The quantities of data are potentially overwhelming: Fingerhut Cos., for example, is currently expanding its collection of mail-order customer data from about 600 billion characters today to about 2 trillion characters, or two terabytes—enough to choke any traditional mainframe. Using shoppers' clubs and other incentives, supermarket chains such as Vons Cos. and Safeway Inc. are starting to keep on hand more than a year's worth of detailed data about customer purchases.

SOUPED UP. Fortunately, powerful new technologies are at hand. Neural-network software, designed after the pattern of cells in the human brain, can automatically "learn" from large sets of data on its own. By scanning thousands of data records again and again, the software can build a strong statistical model describing important relationships and patterns in the data. All that's required is a standard, high-end PC equipped with a plug-in neural-net "accelerator" board. Customer Insight Co. has tailored HNC Software Inc.'s Database Mining Workstation software, based on neural-net techniques, just for database marketing.

Once a statistical model of the ideal customer is constructed, however, considerably more computing horsepower may be required to find all prospects matching the profile. So Fingerhut, Wal-Mart Stores, Delta Air Lines, American Airlines, and dozens of others are turning to so-called parallel-processing systems. These devote dozens or even hundreds of microprocessors to scouring a giant database for records that meet a complex set of criteria. The more criteria speci-

to many "reengineering" efforts these days. Businesses ranging from airlines to banks and telephone companies are striving to reorganize based on a better understanding of their customers' buying patterns. The potential gains are big: tighter inventories, more compelling product displays, fewer out-of-stock items, and higher profits. Says Thomas Blischok, a vice-president at AT&T/NCR: "If I can guarantee that every time you go to my establishment you find stuff to buy, you'll care a lot less about price."

BIG-IRON BRAWL. All of which is stirring sales in the otherwise moribund large-scale computer market. Sales of traditional mainframes have gone into long-term decline. But Gartner Group Inc., a computer market research firm, reckons that today's \$400 million commercial market for parallel computers will grow to \$5 billion in 1995. IBM, the leader in mainframes, is adding parallel systems to its lineup in hopes of thwarting early advances by challengers such as AT&T, Tandem Computers, Sun, Hewlett-Packard, and even Cray Research.

What does the future hold? Lots more transaction data stored in much more powerful computers. Customers' thirst seems insatiable, says Jerre Stead, chief executive of AT&T/NCR. He was recently given a pair of hats when visiting Wal-Mart headquarters, where inspirational slogans abound. One, Stead recalls, demanded that AT&T computers be capable of storing "10 terabytes by the end of '95." The other demanded that "90% of all data [be] processed in 99 minutes." Says Stead: "We'll go there. We're working on it."

By John Verity in New York

KEY DATABASE-MARKETING TECHNOLOGIES

PARALLEL COMPUTERS

Use gangs of microprocessors to scan huge volumes of data in a flash. Sold by AT&T/NCR, IBM, Tandem, Meiko, and nCube.

DATABASE SOFTWARE

Cross-indexes data records into giant matrixes, which makes finding specified records much easier. Sold by Oracle, Sybase, IBM, Informix.

NEURAL-NETWORK SOFTWARE

Can automatically build a model of customer behavior based on analysis of previous transactions. Available from HNC Software, Customer Insight.

DATA: BUSINESS WEEK

fied, the longer a search can take—but the more precisely aimed the resulting marketing efforts may be. Fingerhut has chosen a parallel Sun Microsystems Inc. machine that harnesses as many as 20 high-speed microprocessors. Wal-Mart Stores Inc. leads the way in retail databases using parallel database computers supplied by the former NCR/Teradata company, now a unit of AT&T.

Rapidly analyzing zillions of past business transactions is actually key

BUSINESS WEEK'S CONFERENCE ON THE VIRTUAL OFFICE



The Virtual Office Becomes a Reality

Nomads, rangers, astronauts, road warriors — not your conventional job titles.

But these are not conventional times, as participants at BUSINESS WEEK's Conference on The Virtual Office, held in New York, learned from a lineup of speakers who are reshaping the way people work and the way the world does business.

What is The Virtual Office?

Without minimizing the difficulties, the conference speakers were upbeat about the changes. Representing a range of disciplines including real estate, information technology, and human resources, the speakers defined the virtual office phenomenon.

Alan Soucy, vice president of mobile systems at Zenith Data Systems, takes what he calls a "PC-centric" point of view. "The virtual office," he says, "is an evolutionary stage in the life of personal computing," a progression from stand-alone applications to "social computing" and "group knowledge."

To Thomas J. Villani, director of marketing and new business development for AT&T Virtual Office Solutions, the virtual office is a business strategy that allows people to work wherever and whenever they work best.



"We're beginning to realize there is a difference between a place called the office and the activity called office work," agrees Gil Gordon, editor-in-chief of *Telecommuting Review* and a virtual office consultant.

Keynote speaker Paul Saffo, a director of the Institute For The Future, says we are at the end of "work as an

"The virtual office is an evolutionary stage in the life of personal computing."



Alan Soucy
vice president, mobile systems
Zenith Data Systems

industrial process." Business, he claims, is moving toward biologically based models...the organization as organism. About 10 percent of the workforce will have no fixed workspace at all, Saffo predicts, and a greater percentage will be away from their desks most of the time. To support and benefit from such individuals "organization structure must profoundly change," says Saffo.

For Michael A. Bell, director of corporate real estate for The Dun & Bradstreet Corporation, the virtual office is "not a place but a process, a new way of working and managing."

Virtuality Brings Real Benefits

Why pursue such a transformation? There are very tangible benefits: cost reductions, productivity boosts, faster

response times, and increased workforce flexibility. And perhaps most important of all in today's competitive environment, the need for continuous business transformation is essential. Or as Woodrow (Sonny) Angle, regional vice-president, NEC Technologies, Inc. commented, "If it's not broken, break it."

Ernst & Young, one of the early adopters of the virtual office concept, has sharply reduced overhead costs and seen productivity soar since it began a program that includes telecommuting, "hoteling," and the establishment of "activity centers."

"We realized more benefits than we expected," reports David A. Tierno, managing director, northeast management consulting group, Ernst & Young. "We reduced space costs by 40 percent. We anticipated productivity boosts of 10 to 15 percent, but got 20 to 25 percent."

The virtual office concept lends itself particularly to targeted applications. Robert F. Preston, vice-president, North and South American sales, Xircom, pointed out that benefits can be realized by field sales and support in the form of instantly available price quotes, inventory checks, and access to contact management systems.

Martin F. Pospeshil, manager of alternative officing strategies for AT&T's global real estate organization, reports similar results, but with an added bonus: worker satisfaction increased significantly, and there was a 15 to 20 percent increase in customer contact. All this in addition to a \$21 million reduction in occupancy costs.

IBM PC Company Pen Computing program manager, Jim Alfaro, who

works out of his home in Boca Raton says that on the plus side, "I've got no commute time, fewer distractions, work flexible hours and I wear casual clothes." Down-side effects? The absence of daily recognition for your work. "You need strong self-confidence. Still I tell people how I work and they say 'you are one lucky guy.' And you know they're right."

The Technology Enabler

Technology, particularly miniaturized new computers and mobile communications, are in the process of becoming indispensable essentials of daily business life. AT&T's Villani's toolkit includes a personal computing device such as a sub-notebook, laptop, or personal digital assistant (with modem) and a communications platform such as a cellular phone or pager. These personal tools must be joined by network access (including information services), software solutions, database synchronization, and specialized support services.

Raymond P. Dolan, vice-president marketing, NYNEX Mobile Communications, says data communications fo

"The virtual office lets people work anytime, anywhere."



Thomas J. Villani
director, marketing & new business
development, AT&T Virtual Office
Solutions

"If it's not broken,
break it."



Woodrow (Sonny) Angle
regional sales vice-president
NEC Technologies, Inc.

ual Office users will consist of a mix wireless technologies including circuit-switched cellular, enhanced cellular, modem pools and data gateways, and Cellular Digital Packet Data (CDPD). He noted that existing land line services such as ISDN will also play a vital role. Ultimately, the application (field force automation, telecommuting, etc...) will determine what combination of data communications services best enables the business to reach its goals for the virtual Office worker.

When selecting technology, Chris Chiat, president of MicroAge Infosystems Services, notes that management must pay just as much attention to "bottom-up" considerations as it does to strategic ones. Essentials include planning for customer requirements, evaluating pilot projects, and systems integration. Support can take a variety of forms including help desks, maintenance services, and remote diagnostics. Chiat stresses comprehensive user training. "Partnering with a reseller to provide many of these essential bottom-up services can help ensure the client's success," he said.

To forestall costly and embarrassing slips, Sandy Apgar, principal of Apgar

& Company and a former McKinsey strategic consultant, offers six key success factors: (1) the need for change must be accepted and codified; (2) the relationship between space, work functions, and work time must be analyzed and understood; (3) the workforce should be differentiated by activities into those who will function best in the office, as "road warriors," or as telecommuters; (4) workplace/workspace options should be selected mainly for their productivity impact; (5) work tools and training must be provided; and (6) the "right" to space should be redefined by incentives and performance measures that focus on productive output.

But even with the right technology, the right partners, and the best of intentions, the virtual office will not be to everyone's liking.

As Jay Chiat, managing partner of Chiat/Day, points out, "If getting to the corner office is the biggest thing in your life, the virtual office is not for you." Chiat says that at his advertising agency, the virtual office changed the company culture from one of tight management control to a freer, looser organization. Employees now work as teams and are rewarded as teams. The company is determinedly client-centered.

"There's no place to hide," says Chiat, but also, "If somebody's good, you immediately know it." The result, he says, is a far more upbeat, invigorating environment, wholly focused on the client's needs rather than on individual perks or politics.

Corporate Culture Critical

Team-oriented organizations like Ernst & Young and Chiat/Day have an edge in implementing the virtual office.

Companies with a rigid, hierarchical command and control structure may find the virtual office to be a cultural and organizational earthquake — particularly among certain kinds of employees. Politically-oriented individuals often feel threatened as time-honored office perks disappear. American office culture stresses individual accomplishment, while many virtual offices are rooted in the creation of remote teams — an unusual new role that some workers may be unwilling or even unable to assume.

At the same time, the virtual office also empowers the worker, and frees the individual in both space and time. That's a plus to many people — but not to all. The traditional rigid, rule-oriented, and obedient "corporate personality" does not fit well in a virtual office environment. In time, this is certain to

"I tell people how I work and they say, 'you are one lucky guy.'"



Jim Alfaro
program manager
IBM PC Company, North America

change the definition of the "corporate personality," and make corporate employment attractive to free-spirited sorts of individuals who have avoided big company jobs in the past.

Apgar comments, "visual management needs to be replaced with 'virtual leadership,' which calls for delegation, trust, and teamwork. Managers must



learn to judge employees on actual work produced only, and not on 'face-time,' an engaging personality, or on just looking busy."

Most managers are not comfortable commanding people they can't see. But in a virtual environment, managers may be working with widely — even globally — dispersed teams. Despite the difficulties, most of the conference participants see the adoption of virtual office concepts as inevitable for most corporations. They advise a gradual implementation, and stress the need for comprehensive training and employee communications.

"Pick your partners first, not the technology."



Alan P. Hald
vice chairman & co-founder
MicroAge, Inc.

The Management Challenge

Alan Hald, vice-chairman and co-founder of MicroAge, offers a checklist of practical steps for implementing virtual office concepts. Choose the first project wisely, he counsels. Listen for the squeaky wheel: Respond to where the demand is strongest within your company. Be aware of what your competition is doing.

"Pick your partners first, not the technology," says Hald. In-sourced partners include: the business unit;

human resources; facilities management; information systems; and telecommunications. Outsourced resources include: the telecommunications service provider; a systems implementer to assist in the technology planning, installation, training, and support; and perhaps a business consultant to help deal with cultural and managerial issues.

In choosing technology, Hald stresses open standards, and "plug and play." Also crucial is the choice of an applications development environment to permit rapid prototyping of new applications.

With the first project designed, working, and supported, evaluation is next. Consideration of human factors is critical. Is there, for example, a disconnect between individual and organizational expectations? Or between expectations and results?

Hald emphasizes the need for a "champion," a highly placed executive who actively supports the project. Usually the immense overhead cost savings and upsurge in employee productivity the champion can cite makes rapid believers out of more reluctant executives and managers.

Working Anytime, Anywhere

It's all part of rapidly evolving strategies that are creating new ways of manipulating space and time and changing the face of the corporate workplace.

"The virtual office is only part of the solution," comments Michael L. Joroff, director of research and special projects at the MIT School of Architecture and Planning. "It is part of an

Immediate Audience Feedback From Quick Tally

Attendees at BUSINESS WEEK's Conference on The Virtual Office, mainly senior information systems and business unit managers, received immediate feedback from their colleagues using an electronic polling system from Quick Tally Interactive Systems. Questions were flashed on the auditorium's screen and the audience used a keypad at their seat to respond. Here's a sampling:

When asked if they work at home at least one or two days a month, 49 percent of the attendees replied in the affirmative.

Almost the entire audience indicated that their companies would be implementing virtual office concepts in 1994-95.

39 percent see poor implementation as the biggest obstacle to avoid. Also high on the list is manager resistance (32 percent). Turf battles rank a distant third at 15 percent.

The high interest in the virtual office is an indicator of the rapid pace of technology change that corporate America is undergoing. When the attendees were asked if their company was going to re-engineer in the next one to three years, fully 97 percent answered in the affirmative.

In-hall polling provided by Quick Tally Interactive Systems, Beverly Hills, CA

unfolding change in corporate business having to do with how we bring people together."

As AT&T's Villani adds, "The virtual office is a business strategy, one that location independent, one that lets people work anytime, anywhere."

The corporation will never be the same.

This report was written by John Kirkley, a New York based writer on information technology. Mr. Kirkley is also Program Advisor to BUSINESS WEEK in the creation of The BUSINESS WEEK Conference on The Virtual Office

THE DRUGMAKERS VS. THE TRUSTBUSTERS

FTC is eyeing big companies' tactics against makers of generics

Last fall, Upjohn Co. was on the brink of losing a mother lode. Xanax, its blockbuster tranquilizer, reached the end of its 17-year patent term in October. Without the legal monopoly patent protection provides, little pills of blue, pink, or white expect lower-priced generic substitutes to flood the market and eat away market share and earnings. So the nazoo (Mich.) company made a pre-emptive strike: It released its own generic form of Xanax a month before the patent expired and before competitors could bring out their versions.

The ploy was a smash. By June, Upjohn controlled 90% of the market for generic Xanax, according to IMS America, a drug-industry research firm in South Meeting, Pa. The closest competitor had a mere 6.5%, IMS says. Normally, a generic version can grab one-tenth to one-half of the market. Upjohn chairman John L. Zabriskie crows: "This strategy has paid great dividends."

WARY. Selling generic versions of their own drugs is only one of the tactics big pharmaceutical houses are using to fend off pesky competitors (table). These efforts have raised eyebrows in Washington. Since November, trustees at the Federal Trade Commission have opened a dozen inquiries into moves by brand-name drugmakers to compete with generics, which have low costs because they do little innovation. The FTC is devising novel antitrust strategies to see if perpetuating a patent monopoly beyond its expiration violates the law. "We're looking at any conduct that extends patent rights beyond their legitimate scope," says Mark D. Whitten, acting deputy director of the FTC's Bureau of Competition.

The government is pondering intervention at a highly critical time for the industry. A decade ago, the generics' market share was only 21%, but today it accounts for 37% of the \$60 billion prescription drug market, according to David F. Saks, an analyst at Gruntal & Co. And that number will soon rise: Patents for today's 75 best-selling brand-name drugs, which expire by 2010, gener-

ated \$20 billion in sales last year—and few blockbusters are in the pipeline. The FTC faces a quandary: If brand-name companies bring generics to market early and engage in price wars, consumers benefit. But this strategy may lessen competition long term. While the majors legally can use that ploy, it might force generics into niche markets, leav-

To break up the alleged monopoly, the FTC required Marion to license its drug to another company. That is likely to happen soon.

But the main focus of FTC probes is the sale of generic drugs by brand-name companies—especially before patents on the originals expire. During the past year, a half dozen companies—including Upjohn, Syntex, Ciba-Geigy, and Bristol-Myers Squibb—have tried this preemptive gambit.

Pharmacists say it's brilliant. Drug stores usually buy the first low-cost alternative, then rarely switch to other brands once customers get used to it. What's more, early entry into the generic market by big drugmakers can keep initial prices high. The majors often price generics at only 10% to 25% less than the brand-name price, while

ELBOWING THE COMPETITION

To thwart generic-drug rivals, brand-name pharmaceutical companies are:

- STARTING** or acquiring their own generic units. Marion Merrell Dow, for example, purchased the Rugby-Darby Group, the only other maker of Marion's drug for irritable bowel syndrome.
- LAUNCHING** generic versions of their blockbuster drugs before the patents expire. The practice may enable such companies as Syntex and Upjohn to maintain market dominance.
- SUING** competitors for patent infringement, objecting to pending FDA generic-drug approvals, and pushing for state laws to hold off generic competition.

SOURCE: BUSINESS WEEK



ing the majors to dominate generics—and keep prices high. "The goal is to drive the generics out of the business," fumes Morton H. Katz, chairman of Clay-Park Laboratories Inc., a Bronx (N.Y.) generic drugmaker.

The FTC has already clamped down on a move by one big drug company. On June 22, it signed a settlement with Kansas City (Mo.)'s Marion Merrell Dow Inc. involving its purchase of generic giant Rugby-Darby Group. The two companies were the only manufacturers of a treatment for irritable bowel syndrome.

generics ideally should be half the full price.

Generic drugmakers think preemptive introductions are dirty pool. "We have a better-than-even chance of having a majority market share if everyone launches their products on the same day," says William A. Fletcher, president of generic Lemmon Co., based in Sellersville, Pa. That's just what happened with Tagamet, SmithKline Beecham Corp.'s ulcer drug. After Tagamet's patent expired in May, the Philadelphia company released a generic form alongside those

of other companies. A month later, generic giant Mylan Laboratories Inc. led the new market with a 44% share, while SmithKline's sales partner, an American Cyanamid Co. division, had only 15%, according to IMS.

Nothing highlights the FTC's enforcement dilemma better than the fate of Syntex Corp.'s Naprosyn, which industry sources say the agency is investigating. The Palo Alto (Calif.) company launched the generic version of its arthritis pill last October—two months before the patent expired. By June, Syntex had grabbed 68% of the generic market, while the next-biggest competitor, Mylan, got only 17%, IMS says.

SHOT IN THE FOOT. But drug analyst Hemant K. Shah says that competition forced the generic price to plunge as much as 90% below Naprosyn's. That's a boon to consumers. And Syntex lost nearly two-thirds of the market for its brand-name drug to generics, according to IMS. While Syntex still controls almost 80% of the total Naprosyn and generic market, its third-quarter earnings declined 45% from the previous year. The weakened company is now being acquired by Switzerland's Roche Holdings. The FTC and Syntex decline to comment on whether Syntex is under investigation.

The FTC's concerns, however, focus on the long-range impact of such price wars. Falling prices for the generic form of Naprosyn hurt all sellers. "Syntex shot itself in the foot, and it shot other people in the feet, too," complains Mylan Chairman Milan Puskar. If generic companies can't make a profit with their copycat versions of blockbusters, they may abandon the market. And big companies will have little incentive to make cheap forms of their best-sellers.

Those concerns are buttressed by the rapid consolidation of the drug industry. In the past year, the FTC approved two acquisitions—by SmithKline and Merck & Co.—of distributors that package low-cost drug benefits for employers. Critics say the purchases snuff out a key source of price competition. The agency's review of a similar purchase by Eli Lilly & Co. of McKesson Corp.'s PCS should conclude in November. The FTC says it will take a harder look now that the market is more concentrated.

So far, the FTC hasn't decided whether to sue drug companies for unfair competition. But President Clinton is expected to fill two openings on the five-member agency with aggressive enforcers, who may back tougher antitrust cases. In the meantime, "we're trying to let the industry know that we're on the beat," says one FTC lawyer. The agency hopes the spotlight will pay off for consumers in lower drug prices.

By Catherine Yang in Washington

Legal Affairs

LAW FIRMS

DID BIG TOBACCO'S BARRISTER SET UP A SMOKE SCREEN?

Shook Hardy may catch heat for alleged misuse of study results



SHOOK HARDY PRESIDENT McLARNEY SAYS THE FIRM HAS HIRED DEFENSE COUNSEL

In Christopher Buckley's satirical novel *Thank You For Smoking*, Smoot, Hawking is an Omaha-based law firm doing whatever it takes to beat back dying smokers' claims against the tobacco industry. In real life, that onerous task for the past three decades has fallen to Shook, Hardy & Bacon, a Kansas City (Mo.) firm that has made the most of the opportunity. In hundreds of cases, Shook Hardy has made sure its tobacco clients have never paid out a dime to plaintiffs who blame tobacco makers for the deaths of thousands of Americans. "These are ferocious litigators," says Donald W. Garner, a professor at Southern Illinois University School of Law who worked as a consultant to the government's Office on Smoking & Health.

Yet Shook Hardy is more than just the hired gun for the cigarette industry. The firm is a singular amalgam of mostly country lawyers working side by side with scientists and other experts in fields ranging from endocrinology to zoology to pharmacology. Shook Hardy

has leveraged its tobacco representation so successfully that it is now the firm of choice for many companies plagued by high-stakes and often controversial product-liability woes. Several clients would top a who's who of politically incorrect. In addition to cigarette makers Philip Morris, Brown & Williamson Tobacco, and Lorillard, Shook Hardy represents gunmaker Colt Industries and is national counsel for Upjohn Co. in cases involving the sedative Halothane. It also defends Eli Lilly, Merrell Dow, Bristol-Myers Squibb, Merck, and other drug and medical device makers hit by claims that their products harm consumers.

BIAS LABEL. Even the firm's pro-business work is controversial, such as its defense of the Ku Klux Klan in a 1990 free-speech case. Shook Hardy knows that some of its clients are, well, unpopular. But firm President Patrick McLarney insists that "everybody is entitled to a lawyer." Says McLarney, "Just because nobody likes them, people

they can do things to them that could do to nobody else." Now Shook Hardy needs a good law of its own. Earlier this year, the was sued in federal court in Tyler, for allegedly conspiring with Up- to keep information about the dan- of Halcion from the public. The denies the charges and contends suing lawyers is merely a means for ing at corporate clients. "Shook ly will be fully vindicated," asserts ner Harvey L. Kaplan. The Halcion charges aren't the only

Plaintiff lawyers say that by funneling scientific research through the law firm, cigarette makers and their lawyers im- properly used the attorney-client privi- lege to ensure that information damag- ing to the industry would remain secret.

Shook Hardy freely acknowledges its close ties to the industry's scientific ef- forts. But the firm steadfastly denies any wrongdoing, noting that any studies with which the firm was involved were connected to ongoing or anticipated liti- gation. "We're aware of the black-hat image tobacco has, so we've been super

as well as choosing particular research projects for industry funding. In more than 10 letters between Shook Hardy and tobacco company officials or re- searchers, the level of lawyer participa- tion in scientific endeavors appears con- siderable. A 1979 letter from Shook Hardy to Martin J. Cline, at that time a professor of medical oncology at the Uni- versity of California at Los Angeles, not only includes \$350,000 in checks payable to the school and Dr. Cline but also re- quests review of a press release con- cerning industry-funded research before it is made public.

SCIENCE LESSON? Such arrange- ments between Shook Hardy and the scientific community aren't nov- el. Dr. Gary Huber, a lung special- ist at the University of Texas Health Science Center in Tyler, has been performing smoking- and health-related research for years. His articles debunking government conclusions about the dangers of secondhand tobacco smoke are of- ten cited. Since 1986, Shook Hardy has reimbursed the health center for time Huber spends on smok- ing-related projects. "I'm sure the other side, so to speak, would ar- gue that Huber is not completely independent because he's done work for a number of years, wheth- er directly or indirectly, paid for by tobacco companies," says Hardy, whose father tried the first smok- ing case back in 1962. He main- tains that their relationship has been completely open and above board, and that all of Dr. Huber's work is "objective science."

Huber could not be reached for comment. But a statement issued by the health center states: "As with any extra- mural funding source, these monies have been used in the course of his re- search.... Dr. Huber has stated that he has not received personal compensation or benefit from the tobacco industry since he has been at the University of Texas Health Center."

Still, critics wonder whether Shook Hardy took its job of defending its cli- ents too far. That suggestion is being taken seriously—perhaps in part because it threatens to undermine the firm's bread-and-butter business, which con- tributes an estimated \$15 million annual- ly to Shook Hardy's coffers. McLarney says the firm recently hired defense counsel and has taken out "all the insur- ance we can get." But these precautions, McLarney adds, are being taken only out of fear of the havoc wreaked by costly and protracted litigation, not be- cause of liability concerns. "It doesn't matter if they're right or wrong," ex- plains McLarney. "The concern is that

THE ROOTS OF SHOOK, HARDY & BACON

1889 Alderson & Sebree, which later became Shook, Hardy & Bacon, is founded. The firm specializ- es in general litigation defense work.

1962 Partner David R. Hardy suc- cessfully tries first smoking case, Ross vs. Philip Morris. The victory is the start of a relationship with to- bacco manufacturers that has lasted more than three decades.

1972 Shook Hardy launches into pharmaceutical work representing Eli Lilly in an oral contraceptive case. Plaintiffs win \$10,000.

1979 Jennings J. Newcom, a cor- porate finance specialist, joins Shook Hardy to diversify the firm's practice.

1988 Survivors of Rose Cipollone are awarded \$400,000 in the first and only case in which a cigarette maker is found liable for a smok- ing-related illness. Although the award against Liggett is later over- turned, Shook Hardy's clients in the case, Philip Morris and Lorillard, have no liability.

1993 Shook Hardy becomes lead counsel in a \$19 billion debt re- structuring of Ferruzzi-Montedison Group.

1994 Shook Hardy is sued in con- nection with its work for Upjohn in a Halcion case. Other suits are ex- pected relating to the firm's tobacco work.

DATA: SHOOK, HARDY & BACON; BUSINESS WEEK

s dogging Shook Hardy. In a 1992 ker's case, Judge H. Lee Sarokin is- l a stinging opinion suggesting that tobacco industry, with the help of its sel, withheld from the public suppos- independent scientific studies, ded- ing on their potential impact on li- ty suits. "If that is true, then the ' of selected information generated 'litigation' purposes... in and of itself blishes fraudulent intent," wrote the ge, who was later forced off the case the industry for allegedly being bid. Sarokin was "mistaken," says id K. Hardy, co-chair of the firm's awyer tobacco group. "Researchers e encouraged to publish, and much of research was published."

Nonetheless, Sarokin's opinion, along h a steady stream of leaked docu- ments illustrating Shook Hardy's inte- involvement with tobacco-related th research, has sparked numerous iuries. Soon, Shook Hardy is expected be named co-defendant in several s pending against its tobacco clients.

careful," says Hardy. "We know we're under a microscope."

That's not surprising, given the dev- astating consequences facing the industry if plaintiffs can prove their case. Many documents about the tobacco companies' health-related research would be made public for the first time. "The lawyers have kept the genie in the bottle by keeping the cap on the bottle," argues Ronald L. Motley, a plaintiff lawyer suing tobacco companies who plans to add Shook Hardy to his list of defendants. "They have allowed the legal process to insulate corporations from legal liability."

According to documents obtained by BUSINESS WEEK, Shook Hardy lawyers have had a hand in selecting scientists

The tobacco business contributes nearly \$15 million a year to the firm's coffers

litigation drags you down."

It does, however, pay extremely well if you're good at it. Thirty-one years ago, Shook Hardy was a 16-lawyer firm devoted primarily to insurance defense work. Now, the firm operates from 10 floors in a swank skyscraper, boasts 600 employees, and generates some \$60 million in annual revenues. Despite the growth, however, partners say the firm hasn't strayed from its roots as a country law firm whose attorneys are fresh off the farm or from small-town Middle America. Among the highest accolades a litigator can receive after winning a jury trial is a rubber chicken hung on the victorious lawyer's door. "Getting the chicken is more important than how much you get paid," says McLarney.

MIXED BLESSING. That perception seems at odds with what one former Shook Hardy partner describes as litigators' willingness to "take off their gloves and put on brass knuckles." The firm's lawyers bristle at the suggestion that they fight dirty. Says John C. Dods, head of the firm's general litigation division: "We are playing in the big leagues and throw some hard pitches. But I don't believe we win at all costs."

In the courtroom, such tenacity can yield impressive results. In one of hundreds of cases against G.D. Searle & Co., a woman claimed the company's allegedly defective Copper-7 IUD left her infertile. Borrowing a tobacco-litigation technique, Shook Hardy's Kaplan attacked the woman's husband, a former female impersonator, to convince jurors that the husband's alleged promiscuity, bisexuality, and history of venereal diseases was more likely the cause of the infertility, not Searle's product. The plaintiff's expert medical witness, Dr. Richard L. Sweet, says Kaplan even tried to subpoena his personal income-tax records. "They



LAWYERS NEWCOM, HARDY, AND KAPLAN: DIVERSIFICATION IS KEY

use anything they can," says Sweet.

Yet Shook Hardy offers more than savvy courtroom tacticians. In addition to 203 lawyers, the firm employs more than 100 so-called analysts. And that, ironically, is the source of much of the firm's tobacco-related troubles. The analysts are mostly PhDs and other experts. This in-house capability has proved a mixed blessing: True, it impresses clients and lets Shook Hardy dabble in areas outside the traditional purview of lawyers. But it provides ammunition to adversaries who contend that Shook Hardy gets too close to its clients' operations.

The firm contends that its unusual infrastructure gives it an edge over competitors in complex litigation. For in-

stance, a veterinarian staff helped prove a farm in Texas substituting heat hogs to obtain state certification for its diseased animals. To prove fraud, Shook Hardy showed a jury fresh snouts from the diseased hogs, which the veterinarian had culled and tested. The verdict: \$2.1 million for Shook Hardy's client, Plainview Farm Inc. "They can deal with the medical intricacies of a case and have developed an expertise shared by only a handful of firms," says John C. Jenkins, Eli Lilly Co.'s assistant general counsel. But given the growing furor surround-

ing tobacco companies and other clients, Shook Hardy is wary about relying heavily on drug and cigarette manufacturers' business—which alone accounts for half of the firm's revenues. That's why the partners have taken a tip from their tobacco clients: diversify.

FINANCE FOCUS. Reading the firm's brochure these days, there's barely a mention of the tobacco business. Instead, emphasis is on efforts to go global. With offices already in London and Zurich, Shook Hardy approved plans on August 1 to open an outpost in Milan. In addition, corporate work is emerging as a big part of the firm's portfolio, primarily because of Jennings J. Newcom, a dealmaker hired 15 years ago to build a corporate practice from scratch. "My end of the bargain was to round out a three-legged stool—tobacco, pharmaceuticals, and corporate finance," says Newcom, whose division now contributes 20% of the firm's revenues and is staffed by 44 attorneys.

So Newcom and other corporate lawyers have looked elsewhere for lucrative opportunities, such as the \$19 billion debt restructuring of Italy's Ferruzzi Montedison Group.

Still, tobacco and Shook Hardy are likely to be inseparable for some time. Almost weekly, new lawsuits and charges are being brought against the industry. And even as the legal team becomes a target of growing antismoking forces, its attorneys say they won't back down. No doubt experience from all those years spent in the trenches for clients will come in handy in what looks to be Shook Hardy's greatest challenge yet.

By Linda Himelstein and Richard A. Melcher in Kansas City

A SAMPLING OF SHOOK HARDY'S PRODUCT-LIABILITY WORK

CLIENT	PRODUCT
AMERICAN BRAND TOBACCO	Tobacco
BROWN & WILLIAMSON	Tobacco
CIBA-GEIGY	Herbicides
COLT INDUSTRIES	Guns; truck brakes
ELI LILLY	DPT; smallpox vaccine; DES
FORD MOTOR	Automobiles
G.D. SEARLE	CU-7 IUDs; Lomotil
LORILLARD	Tobacco
OCCIDENTAL PETROLEUM	Agent Orange
PHILIP MORRIS	Tobacco; beer; food
UPJOHN	Halcion

DATA: SHOOK, HARDY & BACON

When the designer in
L.A. showed his collection
via computer to the buyer
in D.C., he reworked each
piece until he saw her smile.

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ing to design. Because you'll not only see
and hear each other, you'll be able to
work on the same document at the same

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FUTURES IMPERFECT

In '94, commodity funds should be making money—but aren't

The Virginia Retirement System thought it was on to a good thing: After its outside commodity-fund managers recorded a 17.6% gain last year, the \$16 billion pension outfit tripled its investment in the futures markets, to \$460 million. Alas, the bottom fell out. With the stakes higher than ever, the Virginians lost 7.3% during the first three months of the year—and by mid-August, they had decided to pull out entirely. They were not alone. On average, commodity funds have declined 1.35% through July 31.

It's stacking up as a lackluster year for commodity funds, pools, and trading advisers, collectively known as "managed futures"—which are like mutual funds except that they invest in markets ranging from interest rates and currencies to grains and metals. And that's surprising. With stocks and bonds floundering and with a whiff of inflation in the air, investors were betting that 1994 would be a terrific year for commodity funds, whose performance tends to run independently of the capital markets. After all, in years such as 1987 and 1990, when stocks were lagging, commodities funds paid off well (chart). That's a big selling point for investors who want a potential source of gains even when other markets are struggling. "That's the Holy Grail," declares Richard A. Pike of RP Consulting Group Inc., who works with Virginia.

REBOUND PRAYERS. Virginia's Aug. 18 decision to dump its managed-futures program took out the industry's biggest U.S. pension customer just as the flow of capital from other sources had started to slow. After soaring to \$23 billion last year, up from \$11 billion in 1991, the amount of money in futures funds inched up barely 2% between January and mid-August, according to *Managed Account Reports*, a New York industry newsletter. With the boom now subsiding, insiders are praying for a rebound. "People usually liquidate just in time to miss a big up move," notes Sol Waksman, pres-

ident of Barclay Trading Group Ltd.

That could be wishful thinking. Markets have proved treacherous this year, confounding traders with sharp reversals. While fund managers generally thrive on volatility, many make their money following trends. The biggest losers this year have been trend-following commodity-trading advisers (CTAs), who use computer models that dictate their market moves. "They need a direction. It doesn't matter if it's up or down," explains Jack D. Schwager, director of futures research at Prudential Securities Inc.

But the trends have been fickle, bobbing when they were expected to weave—and landing body blows to the commodity funds. A case in point were the choppy moves in currency prices earlier this year. At the Chicago Mercantile Exchange, yen-dollar futures rose during 10 trading sessions in January—and fell during 11 sessions, often on alternate days. That spelled trouble for trend-followers such as Colorado Commodities Management Corp., which usually sticks with its positions even when the market reverses. "Most of the time, that helps. This past year, it hasn't," concedes Tenny Lode, president of Col-



WHEN STOCKS SINK COMMODITY FUNDS SHINE UNTIL NOW

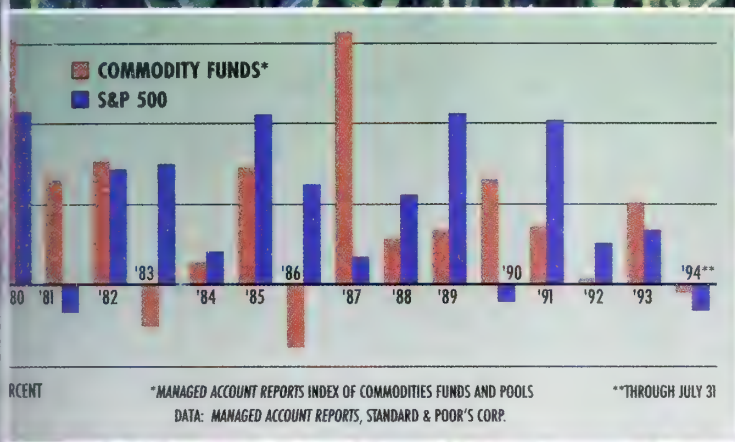
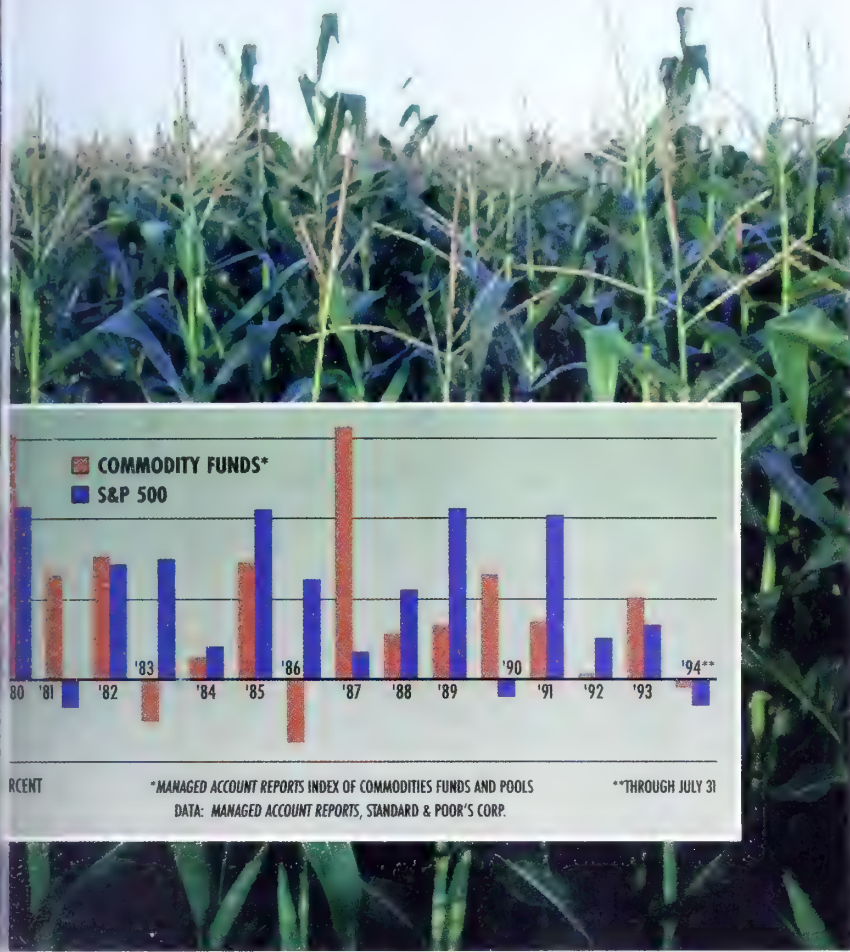
orado, which is down 33% for the year.

It was a different story at H. Niederhoffer Capital Management, which has posted a 20% gain this year using short-term trading tactics instead of the trend-following. When March futures contracts in the yen plunged 95 points on Friday, Jan. 28, and then jumped on Monday, Jan. 31, Niederhoffer closed out its long position at a profit. A trend follower would have added to the position on Monday—and lost money when the market reversed later in the week, according to Roy G. Niederhoffer, who heads the firm. He says: "It's because we're doing something different than don't get caught in the same trade as trend-followers."

Other markets have stung trend-followers as well. Confusion over Federal Reserve interest-rate policies shook oil and foreign government-bond futures. Stock-index futures showed no clear direction. And even coffee, a tiny slice of a market that provided one of the year's few strong rallies, reversed abruptly in July, hurting fund managers who jumped in late.

Many say the trading techniques of fund managers have exacerbated the





this year. Since their systems tend to be similar, technical traders often make the same moves at the same time. This exaggerates price changes, a phenomenon visible in the tempest-tossed markets this spring. "Most of the time comes in on one side of the market. It makes it a lot more difficult to trade," says Jacob Morowitz, who heads the Chicago Board of Trade member firm Morowitz Trading.

IRIE DOWNPOUR. When grain and oil prices plunged in May and June despite favorable weather forecasts, the market came in fits and starts: July soybean futures soared nearly 30¢ per bushel, to \$7.32, on Monday, May 23, then plunged 37¢ the next day, as rain hit the grain belt. (They are trading at about \$5.80 now.) Hedgers and commercial users such as ConAgra, Cargill, and Cargill sold into the rally, coming away with rich trading profits, market sources say. But funds were caught in long positions as the markets fell, and floor traders were swamped and readjusted their positions. That was the last straw for Daniel Markey of AgriAnalysis Inc. in Wheaton, Ill., who quit managing funds

for customers after grain prices collapsed. Convinced that tight stockpiles would provide support, Markey bought corn futures at \$2.90 a bushel early in the year, then rode the market down to \$2.20 before selling out. "It's a time that washes out the trashy CTAs," says Markey, who wryly adds: "That may in-



clude me." He now is focusing his energies on a consulting business for commercial hedgers.

Indeed, some industry insiders expect a shakeout. As money under management soared, the number of active managers has doubled since 1991, to about 500, according to Barclay Research. "There's more money than there are good CTAs to handle it," declares Steve K. DeCook of Fundamental Futures Inc., a Dallas trading adviser founded in 1984.

UNSCHOOLED. One reason for the swelling ranks of CTAs: Steep fees and incentives make it a lucrative business. Even after negotiating special rates based on its huge size, the Virginia Retirement System has paid about 4% annually in management fees and commissions. Smaller customers investing in public funds pay about 6%, industry sources say. And most advisers can pocket additional incentive payments based on their performance—25% of trading profits is not unusual. Those payouts are justified because results depend heavily on individual trading decisions rather than the performance of an asset class such as stocks or bonds, advisers contend.

While Virginia complained about high costs, its decision to end a three-year experiment with managed futures turned on overall performance, says O. Kemp Dozier, the system's chief investment officer. In three years, the program returned about 6% annually after fees, nearly three percentage points below Standard & Poor's 500-stock index in the same period. Although the appointment of a new board unschooled in futures also weighed against the program, Dozier says: "If we had been hitting some home runs, I'm sure they would have been willing to wait another year."

Meantime, fund managers blame board politics for the decision. Virginia pulled the plug even as its goals of diversification and noncorrelation with securities markets were being met, they say. And it didn't give the program enough time. "These investments don't make sense unless you have a five-year time horizon," suggests Aladin T. Abughazaleh, of ATA Research in Dallas.

For Conrail Inc., which invested \$30 million of its \$1 billion pension in managed futures this spring, Virginia's move hasn't changed anyone's mind about sticking with the investment. Declares Thomas J. Conroy, Conrail's director of pension assets: "We're not going to do anything rash." Such patience may pay off—if, that is, the commodities markets come to their senses and start to live up to their glorious contrarian history.

By Greg Burns in Chicago

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THE FUND WINDFALL THAT WASN'T

As too-rosy visions fade, only big banks are likely to offer their own

It seemed like a great idea. Rather than watch customers' money flood into mutual funds, perhaps never to return, banks would launch their own funds. It was almost too easy: With the markets in a three-year boom, consumers were eager to invest in funds, bank branches were a ready-made sales channel, and bank customers were a virtually untapped pool of first-time buyers.

Logical? Yes. Naive? Yes. "There were some pretty unreasonable expectations on the part of some bankers about how quickly they would be able to take the mutual-fund business by storm," says Diane Glossman, a bank-stock analyst at Salomon Brothers Inc. But with the market souring before many were able to build a solid asset base, banks are being forced to rethink the risks and rewards of the fund-management business. Some bank executives are critical of the whole idea: Robert Flowers, head of BankAmerica Corp.'s retail-brokerage unit, has said that most banks should avoid becoming fund managers and that only a handful of bank funds will be successful.

CROWDED FIELD. Many banks focused on the most lucrative approach: launching their own fund families and selling non-bank funds as a stopgap measure until their own funds built performance records. Managing their own funds meant getting lucrative management fees as well as any load fees. But while there are now about 115 proprietary bank mutual funds, only 30 or so have assets of at least \$1 billion in retail funds, and many are still hashing out just what is the most effective way to sell funds. Just 18 funds out of that 115 have total assets of more than \$4 billion—the minimum some industry experts say bank funds need to be profitable. And as skittish investors make new sales harder

to come by, the costs of distributing funds is increasing.

Some smaller banks are even backing away from having their employees sell nonbank funds. Take New York-based Crossland Savings. "They found that the business was inherently difficult to run, that there were big regulatory

al funds are not insured. So rather than keep training its salespeople to sell funds, it plans to use a third party to do the selling for them.

Large banks offering their own funds have other worries. Total retail assets at Citibank's Landmark Funds grew just .09% in the year ending July 31, according to Lipper Analytical Services Inc. And their performance isn't likely to be a selling point, says McNeese. He describes the funds as having "poor performance and high expenses." A Citibank official says fund expenses are competitive and that a number of the funds have been above-average performers over one-year and three-year periods.

A WINNER. At the other end of the spectrum are Chase Manhattan Bank's funds. Because of some good—and

heavily advertised—five-year performance numbers, along with acquisitions of outside mutual funds, retail fund assets at Chase have soared more than 55% in the year ending July 31. Chase's Vista Growth Income Fund saw retail assets almost doubled in the year ending July 31. It returned an average 17.9% for the five-year period ending August 18.

The basic design of many bank funds may also hinder sales. Many banks charge high end loads yet are not perceived as valuable purveyors of investment advice.

Of course, if banks can't sell assets, they may just buy them. Chase did that in its acquisition of six portfolios from Olycom Asset Management last May. The purchase gave Chase not only an expanded channel of distribution for their funds but also a broad line of offerings—something most banks lack.

The most pressing challenge to bank funds may come from rising interest rates. According to *Bank Rate Monitor*, the average annual percentage return on a one-year certificate of deposit was 4.19% as of August 1, up from 3.08% on January 1, a tempting deal for risk-averse investors.

Keeping their customers' money in deposits is a tempting to banks, too, because

of the wide spread between what is paid on deposits and what is charged on loans. So except for perhaps a few large players, it appears that bank funds will be a shrinking breed.

By Suzanne Woolley and Kelley H. Land, with Nanette Byrnes, in New York



A MIXED BAG AMONG BANK FUNDS

	Retail assets* billions	One-year asset growth*
CHASE MANHATTAN	\$3.4	55.06%
CHEMICAL BANKING	4.6	32.52
CITICORP	2.8	.09
J. P. MORGAN	4.1	-8.15
NORWEST	3.4	-18.17

*Year ending 7/31/94

DATA: LIPPER ANALYTICAL SERVICES INC.

penalties for screwing it up, and that it was adding red to their bottom line," says Donald E. McNeese, director of Towers Perrin's New York Financial Institutions Practice. Crossland was also aware of the potential for liability from customers who don't understand that mutu-



IDENT SMITH: THE AARP DEAL GIVES HIM A CAPTIVE AUDIENCE OF 34 MILLION

"S A WONDERFUL HARTFORD LIFE

ITT unit has made some sharp deals, and the spree isn't over

While his competitors reel from hits to their balance sheets—and images—Lowndes A. Smith, president of ITT Corp.'s Hartford Insurance Cos., is sitting pretty. Thanks to a pristine balance sheet and excellent management, the former chief accounting officer for ITT's insurance unit is in the midst of a deal spree that has earned him the envy of his peers.

Smith's latest coup is a doozy: On July 7, after three years of wooing, the American Association of Retired Persons made Hartford Life the 60% owner of a new insurer that will begin marketing annuities exclusively to AARP members in 1995. That's a captive audience of 34 million. And it's a deal that had been sought by every major insurer, as well as by fund giants such as Fidelity Investments.

IN SHEET. The deal is the crowning jewel in a string that Smith has engineered. Thus far in 1994, Smith has bought three insurers—two in the variable annuity market that Hartford Life owns—and signed a joint venture with Argentine insurer Cenit Seguros to take advantage of the government's privatization of the social security system. Hartford Life has been able to outpace its competitors because it hasn't had to worry about bad real estate as-

sets and junk bonds. Real estate, mortgages, and noninvestment-grade securities account for 2% of Hartford Life's investment portfolio, vs. 20% for the average insurer. Such investments have battered balance sheets at insurers such as Travelers Cos. and Mutual of New York. "Hartford Life never had to spend a lot of time worrying about their balance sheet and credit risk in their portfolio," says Lawrence G. Mayewski, a senior vice-president at insurance rating agency A.M. Best Co. "They could expand while others were occupied."

Growth isn't coming just from acquisitions, however. While industry sales of life insurance are down 4% for the first six months of 1994—the first sustained drop in three years—sales growth at Hartford Life is in the double digits, thanks to its high credit rating and hot pursuit of new distribution channels.

The company also has benefited from Smith's quick response to the changing fortunes of health insurers. With reforms threatening to cap premiums and reduce the

need for many health insurers, Smith was the first insurance executive to sell off a health-insurance unit. The sale of the health-insurance portion of Hartford Life's Employee Benefits Div. rid the firm of a capital-intensive unit and freed funds for the firm's growing annuity business. More money came from ITT, which has pumped \$500 million into Hartford Life since 1990. The infusion gives the company a competitive edge: While other firms such as Metropolitan Life have had rating downgrades, Hartford Life holds top marks from Standard & Poor's and A.M. Best.

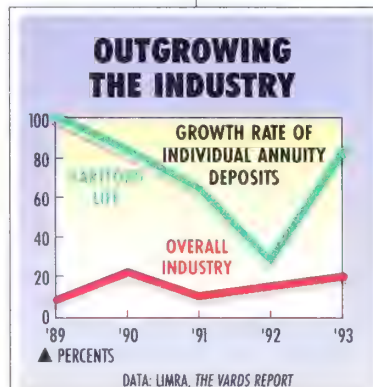
ACQUISITIVE EYE. The soft-spoken Smith has been churning out results since he took over as president of Hartford Life in October, 1989. The \$35 billion company has zipped from No. 25 in the industry to No. 14 in terms of assets. Operating income has mushroomed from \$50 million in 1989 to \$206 million in 1993, and Salomon Brothers Inc. analyst Jay A. Cohen estimates that it will increase 15%, to \$245 million, in 1994 and an additional 12% in 1995. Return on equity has increased from 7.3% in 1989 to 15.8% in 1993. And revenues have swelled from \$1.9 billion to \$2.9 billion over the past two years. Hartford Life, says Cohen, "is one of the star operations in all of ITT."

Can Hartford Life maintain such torrid growth? A slowdown is not on the agenda. The unit sold \$2.7 billion of variable annuities in the first six months of 1994, estimates *The VARDS Report*, an industry newsletter. That's up 7% from last year—in a flat market. Granted, much of that growth came from acquisitions. Now Smith is lining up more distribution channels, signing annuity marketing agreements with banks such as St. Louis-based Boatmen's Bancshares Inc. "We don't want to see anybody walk down the street and not leave us some money," he says.

Smith isn't likely to stop making deals anytime soon. He admits to having an acquisitive eye, and ITT CEO Rand V. Araskog told analysts on July 20 that the company had recently looked at three life insurers and three annuity sellers but had turned each of them down for varying reasons.

There's only one cloud on the horizon for the workaholic Smith: his golf game. He won't disclose his handicap, but he reveals that he lost seven golf balls on a recent outing. With Hartford Life at full tilt, his game can only get worse.

*By Chris Roush in
Simsbury, Conn.*



BY GENE G. MARCIAL

HOW MIRAGE COULD SWEEP THE BOARD IN LAS VEGAS

After a hot winning streak last year, gaming stocks have gone cold. Shares in Caesars World, a premier Las Vegas operator, tumbled from 59 in February to 35 in July. Mirage Resorts, another big operator, dropped from 25 to 17 in three months. But some investors see a lucky ace spurring a comeback: takeovers.

Says one money manager at a \$2 billion New York hedge fund: "We are buying for two reasons: We think the stocks have bottomed, and we see an industry consolidation and, consequently, big buyouts in the making." This pro has placed his biggest bets on Caesars, which has since climbed to 45, and Mirage, now trading at 20.

This investor thinks Mirage is out to acquire Caesars, whose buyout value he puts at \$60 to \$70 a share. He thinks Mirage Chairman and CEO Steve Wynn will attempt a friendly deal. "If he pulls it off, Wynn will own the damn town," he exclaims.

Oppenheimer's Steve Eisenberg says sources hint that Wynn has already looked at Caesars as a target—and it's clear he covets the gaming operator. "But we don't know whether or not he will pull the trigger," says Eisenberg, who says Caesars "is a great buy."

HIGH-ROLLER HEAVEN. Mirage's Wynn, the analyst says, has the deep pockets to pursue Caesars. Furthermore, he argues that a Caesars-Mirage combo would be a nice fit: Caesars has a large following of high rollers—plus the vast banks of slot machines that attract walk-in, mass-market players.

For its part, Mirage—formerly called Golden Nugget—has property: four Nevada casino-hotels, the largest of which is called The Mirage, whose 3,000 hotel rooms and 95,000-sq.-ft. casino accounted for most of 1993's revenues of \$953 million. Next door is the Treasure Island, another Mirage-owned casino, with 2,900 hotel rooms and 75,000 sq. ft. of gambling space. Mirage also expects to have several new Las Vegas facilities operating in two years, including a \$250 million casino-hotel on Mirage's Dunes Hotel property. This new project is co-owned by Mirage and Gold Strike Inn & Casino and will

CAESARS WORLD: BEING EYED?



DATA: BLOOMBERG FINANCIAL MARKETS

aim at "value-oriented vacationers."

Caesars, with revenues of \$983 million last year, owns two casino-hotels in Nevada, one in Atlantic City, and four hotels in the Poconos. Eisenberg expects earnings of \$3.10 a share for the year ended July 30 and \$4.10 next year. At its current price and prospective earnings, says Eisenberg, "Caesars is one of the most attractive, undervalued casino stocks around—with or without a takeover deal." A Caesars spokesman declined comment.

FRESH OOMPH FOR BOX ENERGY?

Of late, shares of Box Energy, trading at 14 in March, have been, well, losing power. Some 50% of its market capitalization has evaporated, with the price down to 7. "The stock is either quicksand—or a great steal," says a Texas investment manager. "We think it's definitely the latter." Several other oil-patch bargain-hunters agree.

What has Box got to entice these pros? "A lot of oil and gas," says investment manager Arnold Schmeidler, who has been snapping up shares. He thinks the company is misunderstood.

A factor that drove the stock down was the recent bankruptcy filing by privately owned Box Brothers Holding, which controls 57% of Box Energy. (The Box brothers are sons of founder Cloyce Box.) The worry was that the filing could result in a change of control. Box Energy President Thomas Box, an executor of his father's estate, insists that control won't change.

"Doesn't matter," says Schmeidler. For one thing, Box Energy's assets are worth more than current stock price, he says. Box Energy, with partners Marathon Oil and Amerada Hess, has a lucrative oil-and-gas-lease property off Louisiana. The natural-gas output jumped from 25 million cubic feet a day last year to 60 million. Box's share is marketed under a contract expiring in 2002, whereby prices rise 10% a year. As a result, second-quarter gas sales jumped to \$13.6 million, up from \$4.3 million a year ago. And six-month cash flow from operations swelled to \$8.2 million vs. \$5.6 million a year ago. Schmeidler sees cash flow of \$2.50 a share this year, so he expects "the stock to hit the \$20-a-share range."

What of fears that the Box family might lose control? Schmeidler says its stake went on the block, likely buyers would be Marathon and Amerada Hess—even better for the stock.

SMELLING GOLD IN VENGOLD

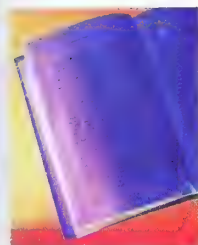
Despite inflation fears, gold stocks have failed to glitter. They have, in fact, been sore losers all year. No matter, says Douglas Kass, research director at J.P. Charles Securities in Boca Raton, Fla. Bearish on stocks all year, Kass isn't necessarily a gold bug, but he's putting money on Vengold, a Canadian company with big stakes in mining properties in Venezuela and on Papua New Guinea's remote Lihir Island. The company has yet to post revenues. All its stock has been battered, collapsing from 12 in February to 3.

So why is Kass crazy for Vengold? He's convinced there is gold in its Oro Uno concession in Venezuela, mainly because the site abuts Placer Doms Las Cristinas property, where more than 7 million ounces of gold were uncovered last year.

Vengold's initial findings then proved disappointing. But, says Kass, Vengold has since discovered "significant mineralizations at Oro Uno—a potential kilometer of gold." Vengold's other prospect, Lihir Island, "boasts one of the world's largest gold deposits," says Kass. He expects Vengold CEO Ian Telfer to sign a pact soon with the Papua government for a license to explore on Lihir.

Vengold's stock is truly undervalued, says Kass, trading at a 60% discount to the company's asset value.

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MARCHING TO MORGADO'S TUNE AT WARNER MUSIC

Now firmly on top of his often feuding labels, he's aiming at MTV

The atmosphere at Warner Music Group's recent sales conference in Nashville was as rueful as any country-and-western ballad. Three days before the Aug. 18 meeting, Mo Ostin, the legendary chairman of Warner Bros. Records Inc., announced his resignation. Now, Ostin was delivering his farewell speech shortly after the very person who had hastened his departure: Warner Chairman Robert J. Morgado. "It was a very emotional event," recalls Danny Goldberg, president of Atlantic Records. "Everybody was crying."

Morgado says he admires Ostin, who built the Warner Bros. label from scratch into a powerhouse over three decades. But colleagues say relations between the two men were strained—in part because Ostin insisted on reporting to Time Warner Inc.'s late chairman, Steven J. Ross, and his successor, Gerald M. Levin. With Ostin gone, Morgado has consolidated his grip on the world's largest music company. "A lot of people had speculated whether Bob had full control over his label executives," says Michael P. Schulhof, chairman of rival Sony Music Entertainment Inc. "These latest moves clearly demonstrate he's running his own show."

VICTORY. It was quite a struggle. When Ross asked Morgado to oversee Warner's music business in 1985, he faced a clutch of labels that acted more like feuding baronies than a cohesive family. Morgado's nonmusic background—he once served as chief of staff to New York Governor Hugh L. Carey—made him suspect to proud record executives such as Ostin. Over nine years, though, Morgado asserted his authority.

Now, with his house in order, the 50-year-old executive is flexing his muscles as a power broker in the industry. His first target is MTV, the music-video juggernaut whom all six major record companies rely on to promote their artists. Morgado has persuaded five of the six to back an alternative music-video channel

to be launched in the U.S. next year. MTV contends that a channel backed by most of the record industry is monopolistic. The claim has found a receptive audience in the U.S. Justice Dept., which recently subpoenaed the five companies involved as part of a preliminary antitrust investigation.

For the low-key Morgado, the government probe is a headache. But he



MORGADO AND CARDBOARD-CUTOUT PALS (CLOCKWISE, FROM TOP LEFT) MEHTA, PAVAROTTI, CARRERAS, DOMINGO

says record companies have little choice but to collaborate in developing new distribution channels for their artists. "Do you know anyone else who would be willing to spend \$100 million to start a music channel?" he asks. Unlike Ostin, who carried on a notorious rivalry with Sony's predecessor company, CBS Records, Morgado has an array of joint ventures with Sony.

Critics snipe that Morgado has no feel for music. Indeed, his elegantly appointed office isn't decorated with the gold records that are *de rigueur* among industry executives. But Morgado has compensated for his lack of musical pedi-

gree by naming Doug Morris president of all Warner's U.S. labels. As chairman of the Atlantic Group, Morris revitalized the once creaky label with Stone Temple Pilots and a concert album featuring Luciano Pavarotti, Plácido Domingo, and José Carreras. Indeed, Atlantic has overtaken Warner Bros. Records in U.S. market share (take Warner Bros. President Len Waronker says new releases by Eric Clapton, Neal Young, and Madonna quickly restore its luster).

Together, Warner's 40 wholly or partly owned labels amount to one powerful machine. John Tinker, an analyst at Morgan Stanley Seligman & Co., figures Warner Music Group will generate \$700 million in operating income in 1994, on revenues of \$3.6 billion. With popular non-label artists such as Italy's Laura Pausini, only 55% of Warner's revenues come from overseas. But even in the U.S., Warner owns 21.7% of the business so far this year, according to market researcher SoundScan Inc. Sony Music, its closest rival, has only 15.7%.

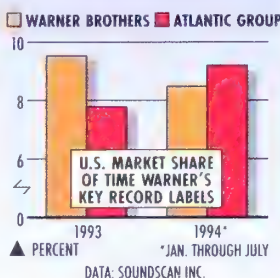
With Warner rolling up big profits, Morgado can focus on outside projects, such as the music-video channel. He insists the venture doesn't violate antitrust laws. His record-company partners—Sony, PolyGram, EMI Music, and Bertelsmann Music Group—will continue to supply music videos to MTV. But Morgado acknowledges that with a viable competing channel, he might be able to charge MTV for videos it now receives free.

TOO BRASH? Industry executives say the Justice Dept.'s scrutiny has unnerved Morgado's partners, though Schulhof says Sony is behind the venture. Morgado says he turned away MCA Inc., the only record company not involved in the venture, because the list of backers had grown too long, but he may invite it back in later: "This is not about them; it's only part of the problem."

With its antitrust implications, some rivals think Morgado's challenge will only end in an embarrassing flop. But after his victory over the unruly fiefdom of Warner Music Group, this record-industry astro seems willing to take that risk.

By Mark Landler
New York

WARNER'S WOES, ATLANTIC'S ASCENT



NOT
SEEING *THE*
VALLEY FOR
THE TREES CAN
RESULT IN
SHORT-
SIGHTED *AND*
UNFORTUNATE
DECISIONS.



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SUPERMATH FOR THE REAL WORLD

Engineers are transforming industry with nonlinear formulas



IBM'S JENSEN USES A LAPTOP AND A WORKSTATION TO CRUNCH INVESTMENT DATA FAST

Above all else, engineers are practical. If developing the perfect camera or oil refinery takes too long, they settle for a design that's "good enough." Increasingly, though, this no longer suffices. In companies driven by competition to wring the last ounce of efficiency from manufacturing and to design products to far tighter tolerances, engineers are being forced to dip into a new mathematics toolbox. And the ultimate result, experts believe, will revolutionize engineering just as quantum mechanics has transformed physics.

The new tools are called nonlinear equations, and the name says it all. These equations are used for precisely describing the behavior of things with an unpredictable facet. That's nearly

everything—from the workings of car engines to the actions of DNA molecules. Even baking a cake is nonlinear: Turning up the oven's temperature twice as high won't bake the cake twice as fast. And with some industrial recipes, such as those for making drugs and plastics, a tiny change in ingredients or processing conditions can mean a huge difference in the finished product. Nonlinear math can help explain such lopsided effects. In short, it "allows you to describe things the way they work in the real world," says David Kinderlehrer, director of the Center for Nonlinear Analysis at the University of Minnesota.

Engineers have shunned nonlinear equations until now because getting good answers is hideously difficult. Since

you can't be sure how any change will affect the outcome, you have to plot every conceivable variation and solve the equations thousands or millions of times. Once, even a simple nonlinear problem was a job for a supercomputer—and the toughest problems are still unsolvable: They would take decades of continuous number-crunching. Now that desktop workstations can run yesterday's supercomputers, mathematicians have the means to tackle a much wider range of industrial challenges. And for many of those still too hot to handle, programmers are writing shortcuts to approximations that are "good enough" a lot better. "Great strides are being made in techniques for solving large, complex problems," says James L. Phillips, manager of mathematics and engineering analysis at Boeing Co.

SHRINK-WRAP. He should know. Boeing has been using such nonlinear techniques as computational fluid dynamics (CFD) since the 1970s. CFD involves carving an airframe's design into thousands of millions of interconnected shapes called finite elements: The more there are, the more accurate the results will be. The resulting computer model is covered with a "mesh," making it look like a shrink-wrapped in graph paper. Then the computer simulates air flowing through each element and integrates all the answers to determine how well the plane will fly. The latest CFD software, which costs a fraction of earlier versions, automatically generates the mesh automatically, saving days of engineering time. As a result, Boeing figures it now pays to revamp aged planes. An upcoming edition of the 30-year-old 737 will be lighter, cheaper to payload, and use less fuel.

The big news is that nonlinear analysis is spreading to many other industries. General Motors Corp. is crash-testing finite-element models instead of cars—and has perfected nonlinear software for designing interior panels. "We'll be able to explore design alterations much more easily than before," says James C. Cavendish, principal research scientist at GM's research center.

A NEW MATH TOOL

Major industries are benefiting from software based on nonlinear math.



AEROSPACE

Engineers can simulate the aerodynamics of entire airframes instead of just wings, improving performance and cutting costs.



BIOTECH

Geneticists are getting a better handle on the complex behavior of DNA. Eventually, biology's most important discoveries may stem from computer, not test-tube, experiments.



CARS

Designers can shape stronger, safer car bodies.



FINANCE

Traders are using "nonlinear optimization" algorithms to help maximize profits and minimize risk.



MANUFACTURING

Chemical and oil producers are devising more efficient production processes, and manufacturers are designing products to tighter tolerance.

M, meanwhile, has turned to CFD to move its hard-disk drives. The read/write head that skims over the disk at 30 mph creates so much aerodynamic pressure that engineers couldn't figure out how to shrink the gap between components to less than one millimeter. With nonlinear equations, they got it down to one micrometer—a thousandth of a millimeter. This boosts storage capacity, since the closer proximity lets the head read and write smaller magnetized bits.

Interest goes beyond high tech. Steelmakers have commissioned studies of furnace designs. And at Los Alamos National Laboratory, Mobil Oil Corp. is using development of software that simulates the movement of oil through porous rock—to help improve extraction techniques.

For virtually any product, there now are nonlinear tools for tinkering with designs and getting accurate feedback in a matter of hours. Engineers are thus spending more time honing designs—of trying hundreds of alternatives, says G. Reyna, manager of analysis and modeling at IBM's Thomas J. Watson Research Laboratory. That's important because 70% to 90% of a product's total cost is fixed during design.

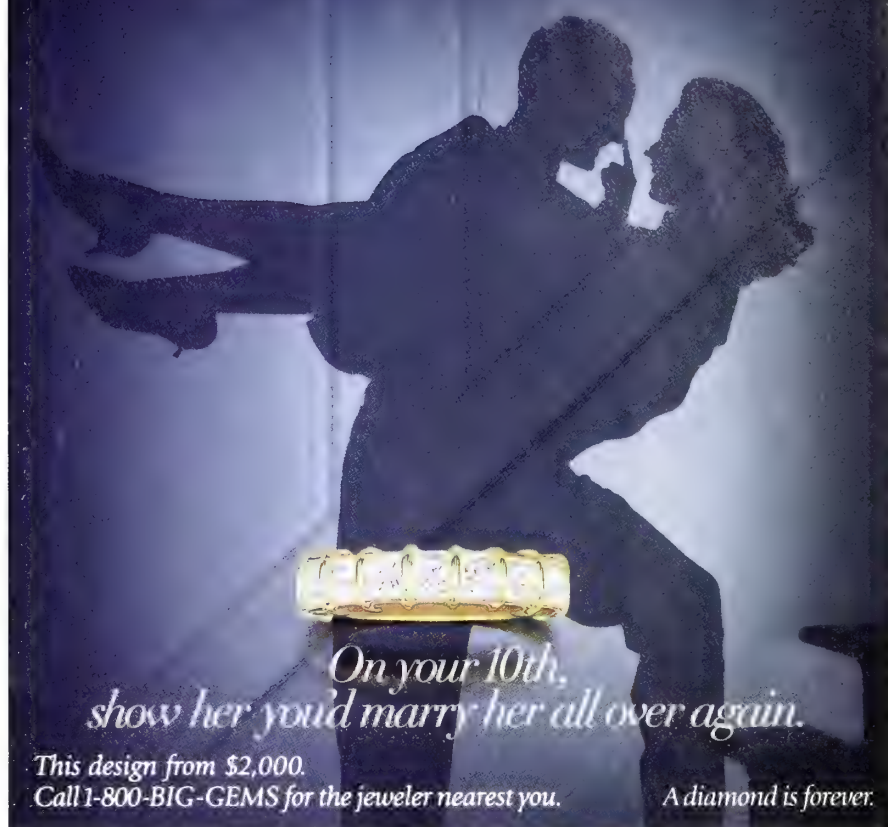
Nonlinear math is also uncovering new approaches to so-called optimization problems—finding the best way to run a factory, schedule a fleet of trucks, manage drivers, or manage a stock portfolio. It's even finding a good-enough solution is tough. But David L. Jensen, manager of mathematical optimization at IBM Research Div., is adapting quadratic optimization to quickly calculate the optimum balance between risk and profit for a portfolio.

GAME. Jensen is typical of the new generation of mathematicians weaned on computers. He taps on his laptop, and a workstation spits out a torrent of numbers. "A portfolio manager can do a collection on the laptop," he says, "and go to a machine with higher horsepower to do calculations." Still, optimizing a portfolio of 500 financial instruments in a matter of seconds is no snap. Now, Jensen has to pare the number of variables to a bare minimum.

Nonlinear math is also opening the door to technologies that were unmanageable a few years ago. It's crucial to build networks that use so-called asynchronous transfer mode (ATM) to transfer data at billions of bits per second—100 times existing speeds. Because data move so fast, ATM systems must be virtually glitch-free—no more than one error per trillion bits, vs. one thousand in conventional networks. Linear optimization provided the answer, says Debasis Mitra, head of AT&T

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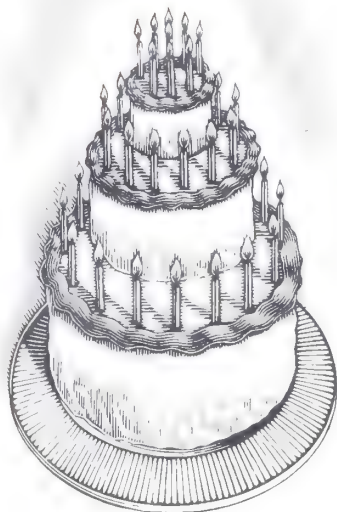
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Bell Laboratories' Mathematics of Works & Systems Dept.

Biotech may get an even bigger boost. Scientists at Los Alamos hope to get a quantitative handle on the human immune system by adapting nonlinear factory simulations. Makes sense. In the way a factory manager revises production for a rush order or when shop equipment clogs, the immune system continually reallocates its cells between building antibodies and cell replication. **RESISTANCE.** Other researchers are trying to develop models for the behavior of DNA molecules. Scientists believe the "folding" action of DNA, in which spiral staircase molecules coil and uncoil, is one key to understanding how proteins work—and could point to new proteins that inhibit cancer. Tamar Schlick, associate professor of mathematics at New York University, is building a DNA model based on nonlinear equations of motion. Eventually, she hopes to simulate enough permutations to simulate a second in the life of DNA.

For engineers, nonlinear math is something of a pain. While mathematicians are good at crunching thousands

Scientists hope to get a handle on the human immune system by adapting nonlinear factory simulations

of nonlinear equations in a jiffy, the final end preparation remains tedious. Setting up a problem takes so long, says David Cavendish, that "the question is how to deliver results quickly enough to have an impact on the design process." Moreover, a finite-element mesh is so complex that finding errors in it is next to impossible—and scientists are just starting to develop software that can flag errors on the screen. Beyond that, inertia is holding back the changeover to the new math. "People seem to prefer poor models they understand well to good models they understand poorly," says Andrew Conn, a Bell Laboratories mathematician.

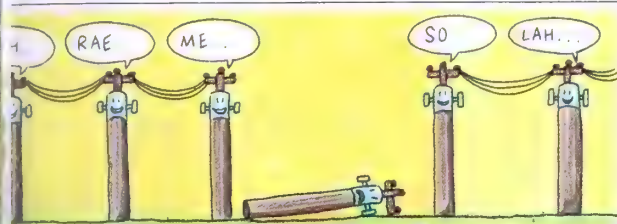
Still, as computers grow more powerful, nonlinear engineering is likely to displace older, cruder methods. Engineers at Eastman Kodak Co. were shaken recently when Kodak began hiring mathematicians to back them up. A more embarrassing example of the old engineering dogma will soon be displaced—like the straw that broke the camel's back. That, incidentally, is a classic example of nonlinearity.

By Fred Gutler in Yorktown Heights, N. Y.

Developments to Watch

BY RUTH COXETER

SMART' POWER METERS MAY HELP CONSERVE PRECIOUS JUICE



feed America's growing energy appetite during peak hours, utilities may spend billions on new power plants the next five years. They would like to limit plant operation by enticing homeowners to shift consumption to peak hours. But creating incentives, such as variable pricing, requires much closer monitoring of usage patterns.

That's why power companies are rushing to automate everything—from meter reading to monitoring outages. To Cellnet Data Systems Inc. in San Carlos, Calif., has led an "intelligent" network system linking thousands of meters and power lines to a power company's computer network via low-cost radio transmitters. Data flow between the transmitters and a central computer that tracks consumption and signals power-line outages. Cellnet is working with Georgia Power Co. and Northern States Power Co. in Minnesota. It just signed a contract to bring Kansas City Power & Light Co.'s 420,000 customers on-line by the end of 1996.

ILL GIANT CRYSTALS GROWN UP GIANT TURBINES?

Ordinary metal alloys look uniform, but under the microscope they're a multicrystalline crazy quilt. That's because when alloys cool, crystals branch out from many points, like frost on a window. At high temperatures, alloys are soft where different crystals abut. To make stronger air-engine parts, scientists at United Technologies Corp.'s Pratt & Whitney Co. in the late 1970s controlled the cooling of nickel alloys so each part was a huge crystal grown from one "seed." That's now the norm for jet-engine parts. Pratt & Whitney Corp. in Greenwich, Conn., a unit of France's Peugeot that makes single-crystal parts for jet engines, hopes to use the technique for the much bigger blades and vanes used in power-generation turbines. Single-crystal parts would allow turbines to run hotter, improving efficiency. Blades in a big gas turbine are a foot or longer, compared with just a few inches for a jet engine. That much molten metal tends to warp in ceramic molds and cool unevenly, so multiple crystals form. Now, Howmet is developing rigid, more durable molds that better furnace controls that guide the crystal to grow from a single seed. It has made parts as long as two feet but not in large quantities.

LEADING EPILEPTIC BRAINS DOWN THEIR WAY BACK TO CHAOS

When biological systems go haywire, order, not chaos, can be the suspect. During chemically induced seizures in rats, for example, neurons fire erratically but in unison—a phenomenon called chanting. Now, scientists at George Wash-

ington University and Georgia Institute of Technology suggest that it's possible to nip human epileptic seizures in the bud by restoring chaotic brain activity before abnormal harmonies take hold.

Suppressing chaotic reactions is routine work for mechanical engineers. And in medicine, electrical pulses are used to smooth out rapid, irregular muscle contractions that cause heart attacks. Deliberately inducing chaos is more controversial, researchers say. Further animal tests are needed before anyone tangles with the human brain. But if all goes well, doctors treating severe epilepsy may no longer need to prescribe heavy drugs, or slice away damaged brain tissue. Instead, they could implant tiny electrodes around the site to detect the rhythmic onset of neuronal "chanting," then nudge the cells back to a more natural state of chaos.

PHOTOCHEMISTRY GETS DOWN TO 'BASICS'

Computer chips and dental work have something in common: Both rely on photochemical reactions. After spreading dental putty, dentists use a blue light to trigger a rapid hardening. Similar chemistry is key to printing circuits on silicon—only the light is ultraviolet. In one common type of photochemistry, light sets off a reaction between a light-sensitive molecule and a polymer, forming cross-linkages in the polymer. The light-sensitive molecule is either an acid or a "free radical," a substance with an extra electron.

Charles Kutal, the University of Georgia's chemistry department chair, is developing a whole new type of photochemistry. He's making light-sensitive molecules that are bases, the opposite of acids. He says acids can linger, causing corrosion. And reactions involving free radicals are inhibited by oxygen. Bases have neither of those problems. Kutal's research team has developed "basic" epoxy compounds that could be used for dental work as well as for chip circuitry, coatings, and inks—and even sutures for eye surgery. He says several companies have expressed interest.

A BUG ALERT FOR BREAKFAST CEREAL

Extra raisins may lure breakfast-cereal buyers. But one additive doesn't: bug parts. "It's a matter of sanitation," says University of Texas at Austin chemist Barrie Kitto. "The more insects you find, the more likely there is contamination from other pests, like rodents."

Current standards permit 75 insect fragments per 50-gram grain sample. But conventional visual inspection misses insect eggs and larvae inside grain kernels. So Kitto developed a simple \$5 test for myosin, a protein present at all stages of an insect's life. A specially treated plastic stick is dipped in a blend of grain and saline solution. The more myosin present, the greener the stick turns. Just two micrograms of myosin in a kilo of wheat can be detected, says Kitto. Major companies such as ConAgra, Pillsbury, and Cargill are evaluating the test.



SPRINT PICKS UP THE PACE

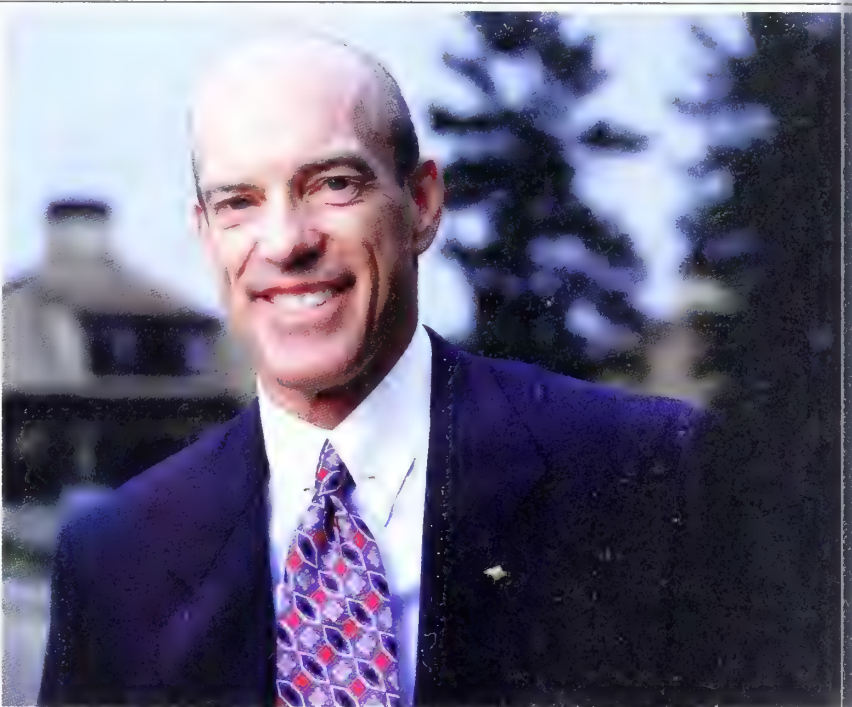
New services, wireless ventures, and European links are giving the No. 3 carrier momentum

For years, Sprint Corp. has been an afterthought in the long-distance market. With only about 9% of the business, it trailed so far behind AT&T and MCI Communications Inc. that it was sometimes literally overlooked. When MCI unleashed a torrent of discount plans in the early 1990s, its catchy ads targeted AT&T, never even acknowledging Kansas City (Mo.)-based Sprint. Meanwhile, poor customer service, ineffective marketing, and billing problems kept a lid on growth and put Sprint's long-distance profits on a roller coaster.

Nobody's overlooking Sprint today. In the past six quarters, its workaholic chairman, William T. Esrey, has pumped new life into the company. Esrey, a former New York investment banker who never leaves home without his laptop computer, chopped \$150 million out of Sprint's cost structure, boosting long-distance operating margins by 69%. A string of new products and services—including a phone card that works with voice commands and an international calling program aimed at high-end customers—have skewed revenue toward more profitable overseas and credit-card calls.

"AN OPPORTUNITY." Granted, Sprint is still a distant third to its long-distance rivals. Its share of the U.S. market crept up from 9.2% in 1991 to 9.4% in 1993. But in the second quarter of this year, Sprint's long-distance revenue growth outpaced MCI's, growing 12.3%, vs. MCI's 11.6%, according to S.G. Warburg & Co. Merrill Lynch & Co. analyst Daniel P. Reingold predicts that Sprint's 1994 earnings will soar 32%, to \$911 million, on sales of \$12.7 billion (chart). That is the kind of news Wall Street loves. Sprint's stock trades at around \$37, up from 31 last fall.

But what's really putting Sprint in the spotlight are Esrey's moves to position the company for a brave new telecommunications world. Watching the ferment



ESREY: STILL PURSUING A DEAL LIKE THE ONE WITH EDS THAT FELL THROUGH

rolling the global telecom industry—deregulation, Information Superhighways, new technology—Esrey sees his chance. "It's an opportunity to transform the company greater than our move into long distance" in 1982. That's when Sprint, née United Telecommunications Inc., was a local phone company. It jumped into long distance with the Sprint service, a partnership with GTE Corp., which sold out in 1992.

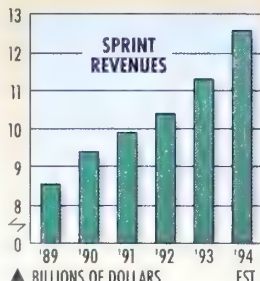
So Esrey, who took the helm in 1990, is wheeling and dealing to make Sprint a global player just like AT&T and MCI. The first move was swapping \$4.2 billion in Sprint stock for cellular operator Centel Corp. But the most important deal came in June, when Esrey arranged to sell 20% of Sprint to France Telecom and Deutsche Bundespost Telekom for \$4.2 million.

The deal, if approved by U.S. and European regulators, will immediately launch Sprint into a higher orbit. For starters, it will gain badly needed access to expand. More important, it will put Sprint a top player, along with MCI and the MCI-British Telecommunications alliance, in the \$30 billion market for so-called global networks. This is the business of selling voice, data, and other communications services to connect the offices of far-flung multinational corporations. Joint ventures with carriers in Canada and Mexico are extending Sprint's global-network reach throughout North America as well.

THE GETAWAY. Today, Sprint carries about 3% of the long-distance traffic of the biggest multinationals. But the French and German phone monopolies together carry 14%, close to AT&T's 16% share. "The benefit to Sprint's long-distance business is huge," says Oppenheimer & Co. analyst Michael Elling.

The partnership wants to run wide information networks for corporations.

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tions also. That was the objective of the deal that got away—Esrey's proposed merger in June with Electronic Data Systems Corp., the computer-systems-integration and consulting giant. The combination would have created a technology colossus, with more than \$20 billion in annual sales, capable of delivering one-stop shopping for information and communications services. The deal cratered when the companies couldn't agree on price, and both sides say talks have ceased. But sources close to Sprint believe an alliance with EDS is still likely. Esrey will only say "an EDS-like" deal remains possible, with EDS or another company altogether.

Certainly, Esrey could use another deal—for growth and for defensive reasons. Over the next few years, the Regional Bell Operating Companies (RBOCs) are almost certain to gain entry into long-distance services. And as the distant third in the U.S. market, Sprint could be the most vulnerable.

Consolidation has already turned LDDS Communications Inc., the nation's No. 4 long-distance carrier, into a much more dangerous rival. On Aug. 22, the company sealed a deal to buy the WilTel Inc. long-distance unit of Williams Cos. for \$2.5 billion. Instead of sending traffic over leased lines, LDDS will now have its own 11,000-mile fiber-optic network.

BABY TALK. That puts additional pressure on Sprint to boost its presence in overseas and cellular markets, including personal communications systems (PCS), a new wireless setup. The renamed Sprint Cellular, the nation's eighth-largest system, brought in \$464 million in revenues and \$24 million in operating income last year, and it will easily triple the income contribution in 1994, say analysts. But Sprint has bigger ambitions: a nationwide cellular/long-distance combine to challenge the network that a merged AT&T-McCaw Cellular Communications Inc. will create.

How to match AT&T/McCaw? Most likely through alliances with Baby Bells. By linking cellular systems and adding PCS networks in other areas, they could create a national service. Esrey isn't saying which Bells he is talking to, but the answer may emerge in October,

when PCS license-bidding teams must register with the Federal Communications Commission. Nynex and Bell Atlantic have already expressed interest in a Sprint link, as have US West Inc. and AirTouch, the former Pacific Telesis Group cellular company.

Esrey's plans all look good on paper. But that doesn't mean they're easy to pull off. For one thing, it may take some doing to nail down the venture with the French and the Germans. Although U.S. regulators are expected to approve the deal, the Administration may use the opportunity to press for faster deregulation of German and French phone markets. Another potential problem: union

venture launch by Apr. 1. The next step: to find an Asian phone company to complete the worldwide network. Sprint Long Distance President Ronald May predicts that the European alliance "will be a magnet for attracting partners in the Pacific."

The global push could have an immediate payoff—in new long-distance business and cash. The \$4.2 billion windfall could help build Sprint's cellular network. Oppenheimer's Elling predicts Sprint will also use up to \$1 billion to cut its \$4.5 billion debt. Sprint has earmarked some funds to upgrade its network as well. Top of the list: state-of-the-art switches and transmission

that will increase capacity and speed to handle data and video.

SHOOT-OUT. Expansion into Canada and Mexico also require cash. Sprint's joint venture with cellular operator Grupo Iusacell must build a long-distance network. But that is not a big worry until 1995, when the Mexican market opens to competition. Right now, Sprint has a bigger shoot-out in Canada, where last August bought 25% of Canam Enterprises and is battling AT&T and MCI, alongside their Canadian partners in the newly deregulated market.

The only Sprint division that is likely to sit at the local-phone operation. Serving mostly rural areas of Nevada, North Carolina, and Florida, Sprint's local operation has for years outperformed

distance. Last year, it posted operating income of \$954 million on revenue of \$4.1 billion. Its low costs yield operating margins in the 8%-to-10% range, compared with about 4% at most RBOCs. Esrey has virtually ruled out expansion once Congress passes a telephone deregulation bill. He figures new players, including cable-TV operators, will rustle local phone markets.

Besides, it isn't through local phone service that Esrey can make Sprint a top-tier global player. When the consolidation that's starting in the industry is finished, he predicts, "there will only be two to five global telecom companies. And Esrey is hoping to deal himself out of that group."

By Kevin Kelly in Kansas City, Mo., with bureau reports

SPRINTING AHEAD

CENTEL Sprint swaps \$4.2 billion in stock for the cellular operator in early 1993, renames the company Sprint Cellular.

CALL-NET Sprint buys 25% for \$65 million in late 1993, gaining entrée into the Canadian market as it begins to deregulate. Call-Net changes its name to Sprint Canada.

ELECTRONIC DATA SYSTEMS A deal to merge Sprint with the computer-services giant collapses in June, 1994, after the pair can't agree on stock valuations, but some sort of partnership still remains possible.

FRANCE TELECOM, DEUTSCHE BUNDESPOST TELEKOM The two European phone companies agree to buy 20% of Sprint for \$4.2 billion, making Sprint a serious player in the growing market to provide international telecommunication services to large corporations.

GRUPO IUSACELL Sprint agrees in late July to form a joint venture with the Mexican phone company to offer national and international long-distance services in Mexico when the market liberalizes in 1997.

LOCAL PHONE COMPANIES Down the road, Sprint is expected to join a national cellular network, perhaps in alliance with several regional Bell operating companies. The company may also be a bidder for personal communications systems licenses, alone or in alliance with other companies at this December's auction.

trouble. The powerful Deutsche Postgewerkschaft (DPG) union recently objected when Sprint laid off 235 employees in a California marketing office just before the workers were to vote on unionizing. DPG wants assurances that German labor practices hold for any Sprint-DT entity in Germany. Sprint says it does not believe labor issues will derail the partnership.

Sprint still hopes for regulatory approval by January, 1995, and a joint-

Eventually, Sprint will need one or more Asian partners to complete its global links

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*The Rittenhouse
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EDITED BY AMY DUNKIN

Travel

NOT-SO-FRIENDLY SKIES FOR FREQUENT FLIERS

Remember the good old days when even your Aunt Hattie in Ft. Lauderdale could boast of earning a frequent-flier ticket to Poughkeepsie? Well, pack those memories away with other relics of the 1980s such as LBOs, yuppies, and Ronald Reagan. For many infrequent air travelers, the '90s have definitely crashed the party. And that giant sucking sound they hear is the value of tens of millions of frequent-flier miles slowly deflating out of their once-rich accounts.

Don't laugh. Beginning next year, most major carriers, including United, American, and Continental, will increase the mileage needed for a free domestic ticket by 25%, or 5,000 miles. Others, such as Delta and Northwest, are dramatically reducing the minimum miles they credit for flights—

making it more difficult to reach award levels. And some are even reducing or restricting mileage earned on foreign partners. The bottom line: It will take more flights or spending with airline-affiliated credit cards or rental car companies for most fliers to earn that coveted freebie.

GOOD RIDDANCE. In fact, it's nearing the point where membership in frequent-flier programs—a symbol of the egalitarianism spawned by airline deregulation—seems hardly worth the bother for many travelers. That shouldn't sadden the airlines, who find it costly to maintain hundreds of thousands of accounts that will never grow enough to redeem even a first-class upgrade. "These programs will return to awarding free travel to the very frequent flier, while the rest of us will be

left to fight over big discount airfares," says John Holland, publisher of *The Business Flyer* newsletter.

That's a dramatic turnabout from the up-and-away '80s, when fare wars, triple mileage promotions, and liberal award charts helped bring

It's going to be tougher to reach award levels, but there are end runs

even grandma and the kids into the flier-plan fold. For example, a marathon weekend trip recounted in these pages in 1988—in which I spent \$319 roundtrip to jet between Chicago-Atlanta-Birmingham-Atlanta-New Orleans-Houston-

Dallas in a single day—then groggily flew the rest of the itinerary on the next—earned me three free tickets, thanks to triple mileage and a selective segment promotion on the joint OnePass program of Continental Airlines and defunct Eastern Airlines.

That same trip today, my older and somewhat portlier body could stand the strain, but it would cost a third more in miles, or net less than a quarter of the mileage. And the penalty isn't about to swing around. "This is essentially a price increase on something that hasn't had a price increase in 20 years," says USAir Marketing Services Director Don Smith. To soften the blow "there are many more ways today to build mileage in your account," he notes.

Unfortunately, even relatively small hikes in re-

ge can knock many fliers out of the 5,000-mile increase domestic ticket at USAir that a short-haul traveler would have to fly up to four flights to earn the award next year. The flight burden is even more if you're working to free travel to Europe, but at United Airlines is about 10,000 miles per ticket, equivalent of about 20 segments between Chicago and Pittsburgh or \$193 a month in additional United card charges for an enabler. Even Delta Airlines' program, which is cutting requirements for members, will hike by the mileage its heavy-flyer edallion members must earn for domestic trips.

MILEAGE. Rather than expecting that the changes make it more difficult for frequent fliers to leave the ground gratis, the carriers dwelled on the declines required mileage for some mass travel, fewer black-boards, or improved senior premium fliers (gentlemen who earn at least 100,000 air miles annually). A little solace if you're not scoring a free flight under the current award schedule and now must be able to top off your account before the increases take. Luckily, if you need a few hundred miles, there are opportunities for a boost. American Air and Delta, for example, require a minimum of 300 miles in order at least \$30 of flowers from FTD or Power Club, respectively, one. And Continental's anniversary promotion, a 60% bonus for actual flown Aug. 10 to Oct. 1, will help many fliers over the top. You need 500 to 1,000 miles, check out the double-mileage hotel promotions on your airline's quarterly newsletter or those re-coupons that are stuck in your flier statement packet. If you're going on a Hawaiian vacation this summer, New York au-

thor Ernest Lieberman rented a car from Alamo Rent-A-Car simply because the company offered a bonus of 1,000 miles in American's flier plan—putting him just over the 20,000-mile threshold to claim a free domestic ticket. "I made a point of beating the increase," says Lieberman.

If you require considerably more miles, consider switching your long-distance service to a carrier allied with your flier program. Signing on with MCI Communications, for one, gives Northwest plan members up to 2,000 miles. And if you're really desperate—and

airlines such as American, you can redeem your miles for an award coupon. Then, you have up to a year to exchange the coupon for a ticket—and up to another year to use the ticket. And you usually can change the travel dates and city on the ticket for a \$25 to \$50 fee.

If you can't earn extra miles and don't want to redeem now, you can always sit on the miles you have and simply settle for a less pricey award destination later. If you currently have 80,000 miles in your United account, for example, you can request two

rentals at National Car Rental. And members of American Express' Membership Miles who link their USAir flier account to the card program through early November will receive a \$99 companion ticket on USAir.

IN THE LOOP? But don't expect to keep receiving word of such goodies if you let your account lie dormant. Many carriers only include details of promotions in their periodic mileage activity statements. So if you don't accrue mileage for an extended period, you won't receive a statement or learn of these specials.

FREQUENT FLIERS FACE SOME DEADLINES

Airline	Change	Effective date
UNITED	Ending liberal award schedule for "original program miles," earned before July 1, 1989	Dec. 15, 1994
	Raising mileage for free domestic and Hawaii travel by 5,000; boosting mileage for coach seats to Europe by 25%	Feb. 1, 1995
USAIR	Raising mileage needed for free domestic ticket by 5,000 miles, to 25,000	Jan. 1, 1995
TWA	Ending the earning of American AAdvantage miles for flights taken on TWA	Jan. 1, 1995
ALASKA	Raising mileage needed for free domestic ticket by 5,000 miles, to 20,000	Feb. 1, 1995
AMERICAN	Raising mileage needed for free domestic ticket by 5,000 miles, to 25,000 miles	Feb. 1, 1995
	Increasing mileage needed for Hawaii coach award by 5,000 miles; reducing mileage for pair of non-domestic first-class tickets	Apr. 1, 1995
CONTINENTAL	Boosting mileage needed for two domestic coach tickets by 43%, or 15,000 miles	Feb. 1, 1995
DELTA	Reducing mileage needed for free domestic ticket by 5,000 miles, to 25,000, but slashing minimum mileage earned per flight by 50%, to 500	May 1, 1995

DATA: AIRLINES, BUSINESS WEEK

willing to stomach its hefty \$80 fee—applying for a Diner's Club International card can yield up to 10,000 flier miles that can be applied to any of 14 carriers. Whatever you do, don't dally, since it can take up to eight weeks for partner credits to show up in your account.

Have enough miles under the current award schedule but don't know yet when you would like to take a trip? On

free coach tickets to Europe. That award jumps to 100,000 miles after Feb. 1. So you could still claim two tickets to Hawaii or the Caribbean for 70,000 miles.

There are benefits to joining flier plans even when you know there's little chance you'll log enough miles to earn free travel. Continental recently sent its program members coupons good for 10% off weekend or weekly

In fact, occasional fliers would do well to focus more closely on the industry's periodic discount fare sales, such as the fall travel promotion on sale through Aug. 31, or on everyday-low-fare carriers like Southwest Airlines. Those may bring the biggest payoff for modest travelers now that the airlines seem intent on making their frequent-flier programs live up to their names.

Jim Ellis

Smart Money

CDs THAT TRY A LITTLE HARDER

Although bank certificate of deposit yields have edged up a bit this year, their 3.5% average has not kept pace with the rise in short-term interest rates. Yet millions of risk-averse savers are still drawn to conventional CDs for their safety and relative liquidity. Well, what if you could essentially have those features in a product that moves more in tandem with interest rates? A switch might be tempting.

Banks are providing some alternatives. Many offer "bump-up" CDs—insured by the Federal Deposit Insurance Corp. for up to \$100,000—whose rates rise at least once during the term of the deposit. For example, Bank Leumi Trust in New York has created the Triple Choice Time Deposit, currently paying 4.75%. Unlike a traditional CD, which locks in at a fixed rate for the full term, this two-year CD lets you bump up the interest once to a higher market rate. Once during the two years, you can also withdraw 50% of the balance without penalty, and you can add up to 100% of your initial deposit whenever you like.

QUICK RESPONSE. First Financial Bank in Milwaukee has a similar 2½-year CD that starts out paying 5.35% a year and jumps 0.75% every six months. At each increase you can add or withdraw money from the account without penalty. First National Bank of Omaha offers a two-tiered, 20-month CD that resets from 5.5% to 7% after 10 months for a yield of 6.57%. A more liquid option

is the Insured Plus Account offered by asset manager Calvert Group in Bethesda, Md. (800 368-2748). The account is cobbled together from three separate banks, so you can be insured for up to \$300,000. But Calvert provides you with one consolidated statement. Tied to 90-day Treasuries, the interest rate, currently at 4.34%, is adjusted weekly, so you get a fairly quick benefit from any rate hikes. In addition, you're allowed six withdrawals a month and can get them by telephone, check (\$2 each), mail, or wire, says David

notes. Also like T-bills, notes issued by the Farm Credit Bureau, Federal Home Loan Bank, and Sallie Mae are exempt from state and local taxes.

If you need to set aside money for a downpayment or have a bond that just matured and want to park the money for just a few days or weeks, you can buy short-term Federal Agency Discount Notes through brokers on the secondary market. But not all discount notes come in small denominations. For instance, you can buy Farm Credit notes in \$5,000 lots,

prime-rate funds has 6.12%. Because they involve loans that banks make, companies, sometimes highly leveraged ones, they do carry credit risk—and can't be compared with CDs when it comes to safety. "Just because these aren't speculative loans, doesn't mean they don't turn out that way," says Michael Lipper, president of fund watcher Lipper Asset Services. But since funds adjust to rising rates, there is almost no price interest-rate risk.

SAFETY IN NUMBERS. The best, and perhaps safest, of the funds is Van Kleeven Merritt Prime Income Trust (800 KAMP), whose default rate has been at 1.8% of the portfolio, says manager Jeff Lett. Some features that offset the balance that risk is that loans are senior and which is paid off first in case of trouble. Another fund is diversified throughout many and 19 industries. It is a very conservative investment," says Lett. The Income Trust has delivered 21.4%, 6.52% a year, and its 3½-year

ALTERNATIVE PARKING PLACES FOR YOUR CASH

Name/Company	Product	Rate*
TRIPLE CHOICE TIME DEPOSIT Bank Leumi	A two-year CD that lets you add or withdraw some percentage of your initial deposit, and reset the rate once	4.75%
INSURED PLUS ACCOUNT Calvert Group	A liquid account that insures up to \$300,000, resets to three-month T-bill	4.34%
FEDERAL AGENCY DISCOUNT NOTES Various brokers and banks	Short-term notes issued by government agencies such as Sallie Mae that look and act like Treasuries but pay more	30-50 points over T-bill
PRIME RATE FUNDS Five mutual fund companies	Invest in senior corporate bank debt that adjusts along with prime. No interest-rate risk, but significant credit risk	6.12%

*As of 8/22/94

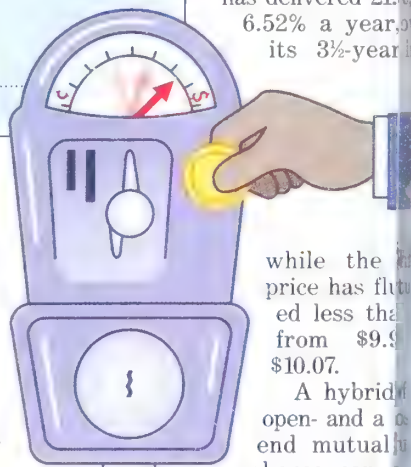
DATA: BUSINESS WEEK

Rieben, director of national sales. You need a minimum of \$1,000 to open an account.

Another convenient place to put your cash is in Federal Agency Discount Notes, available through a limited number of major brokers and banks. Though not FDIC-insured, these short-term notes are issued and backed by government agencies such as Fannie Mae and Freddie Mac. They usually mature in 90 days or less and look and act just like comparable-length Treasuries except that at 4.75% to 4.80%, they return 0.3% to 0.5% more. "They're very liquid and offer almost the same safety as Treasuries," says Doug McAllister, a first vice-president at Prudential, which sells the

but Home Loan notes require a minimum of \$100,000. In addition, Sallie Mae issues six-month floating-rate securities that are indexed to three-month Treasuries and hence are adjusted to new rates each week.

For the slightly more adventurous, there is a quirky breed of mutual fund linked to the prime rate that is being targeted to CD holders. Formerly available only to institutional investors, five funds now sell to individuals. For the past year, the average total return for



while the price has fluctuated less than from \$9.9 to \$10.07.

A hybrid of open- and a closed-end mutual fund shares can be deemed only at quality tender offers, and the back-end load of 3% diminishes over five years. So far, these funds have offered decent returns with low risk. And if they continue to rise, the instruments that float them can help keep them above water. *Pamela*

aveling on a bicycle is great fun. Traveling with a bicycle is a great headache. Lugging it on means roof racks, birdlings, and spattered. If your plans include fly- you haul the two-wheeler airport, struggle to dis- able it in the terminal, ne pieces in a cardboard

Leisure

GOOD BIKES NOW COME IN SMALL PACKAGES

A folding bike is a good choice even for the nontraveler. When living space is tight—especially in an apartment—being able to stow a bicycle under a bed or in a closet keeps it from becoming part of the decor.

RIGID FRAME. Folding bikes have actually been around for a long time but have not been considered

When you're ready to ride, swing the front fork into position, lock the quick-release levers, pop on the front wheel, and off you go.

Montague's Biframe Model 949 mountain bike (\$699) comes with lightweight components, including a slick-shifting Shimano Alivio 21-speed gear set. It delivers a smooth ride, tight handling, and good balance. The frame is surprisingly rigid considering that it folds. The bike is both heavier, at 30 pounds, and pricier than competitive fixed-frame models. On an afternoon of biking on asphalt, dirt, and some serious trails in

MONTAGUE'S 949 BIFRAME MOUNTAIN BIKE FOLDS UP IN ONLY FOUR STEPS. IT PROVED UP TO THE RIGORS OF TRAIL RIDING

For the cyclist who wants full suspension in a super-lightweight, custom-built road or mountain bike, consider Alex Moulton bicycles. These top-end models roll on 20-inch wheels, are priced from \$1,299, and are distributed by Angletech in Woodland Park, Colo. (800 793-3038).

Another made-to-measure folder that uses the midsize 20-inch wheel is the Bike Friday. The distributor, Green Gear Cycling in Eugene, Ore., (800 777-0258) builds three different bike types—touring, mountain, and road racing. Each bicycle is offered with a clever travel suitcase that becomes a rolling trailer for your personal gear after the bike is assembled and ready to ride. The line starts at \$995, with the trailers a \$300 option.

REAR SUSPENSION. Another choice is the Brompton, a more traditional British folding bike. It uses smaller 16-inch wheels and three- or five-speed gearing. The cycle features rear suspension, chrome fenders, and luggage racks. The lightweight bike is

best suited for street riding and sells for \$740. Contact Linear Manufacturing, the U.S. distributor in Guttenberg, Iowa, (319 252-1637).

As more people choose two wheels for their daily commutes, recreation, and exercise, they should know that a bike can now offer a



and pay at least an \$45 each way for leisure. Hardly a to begin a cycling cure. Better idea might bring along one of new generation of ole bikes. Using eight materials high-tech compo- they're designed into compact units that fit in a car's trunk. have hard-shell travel that most airlines will as no-charge baggage.

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serious riding machines because of their small wheels and wobbly frames and because of the limited number of dealerships for sales and service. Many cyclists complained that the portable models simply didn't look or ride like "real" bikes.

Montague Corp. in Cambridge, Mass. (617 491-7200) is one bike builder that's out to change that perception. It sells a full line of folding city, mountain, and tandem bicycles, priced from \$459 to \$1,995. Each uses a "chromoly" steel alloy frame, designed with two concentric seat tubes that provide a pivot point for the bike's front half, including the handlebars and front-wheel-fork assembly, to be unlocked and folded against the rear half of the bike. The design doesn't affect the mechanics of the brakes, gears, or drive chain.

New Jersey's South Mountain Reservation, the 949 proved to be a quick and capable machine.

Montague bikes use conventional, high-quality components and standard 26-inch wheels, so parts and service should not be a problem even if you're on a vacation far from home. Montague also custom builds a folding mountain bike for BMW, which is sold through that carmaker's dealer network.



good ride in a portable design. The incredible folding bike is also guaranteed to turn heads when you take it out of a case, put it together, and ride it away. *Tom Reed*

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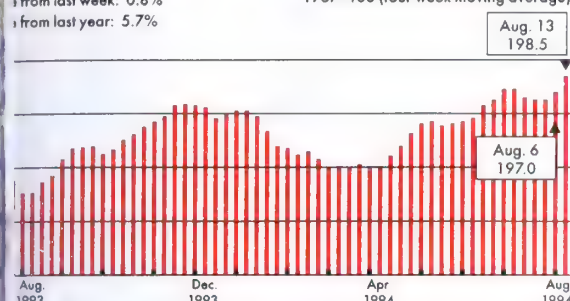
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Business Week Index

PRODUCTION

Change from last week: 0.8%
Change from last year: 5.7%

1967=100 (four-week moving average)

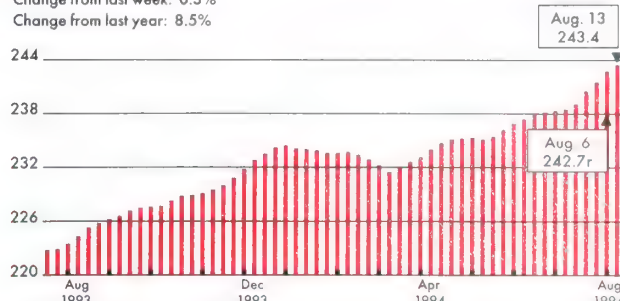


The production index posted a strong advance in the week ended Aug. 13. Seasonal adjustment, steel output climbed higher, as did electric power, coal output, and lumber production. Rail freight traffic was slightly down. Output of both autos and trucks declined, after a big gain in the previous week. Production of both paper and paperboard also fell. Before calculation of the four-week average, the index rose to 199.9 from 198.7.

BW production index copyright 1994 by McGraw-Hill Inc

LEADING

Change from last week: 0.3%
Change from last year: 8.5%



The leading index rose in the week ended Aug. 13. The pace of real estate loans picked up substantially, although the remaining components of the index lost ground. Stock prices edged lower for the week. Materials prices grew at a slower pace. And the M2 money supply slowed sharply, reflecting an unusually large weekly drop of \$18.1 billion. Data for business failures were not available. Before calculation of the four-week average, the index fell to 243.5 from 244.3.

Leading index copyright 1994 by Center for International Business Cycle Research

PRODUCTION INDICATORS

	Latest week	Week ago	% Change year ago
IRON (8/20) thous. of net tons	1,809	1,798#	-3.0
STEEL (8/20) units	122,760	119,127r#	29.7
COAL (8/20) units	118,243	119,556r#	26.7
ELECTRIC POWER (8/20) millions of kilowatt-hours	67,975	67,332#	-2.3
PETROLEUM REFINING (8/20) thous. of bbl./day	14,355	14,388#	2.5
IRON (8/13) thous. of net tons	20,393#	19,539	15.8
STEEL (8/13) thous. of tons	900.9#	919.7r	10.8
COAL (8/13) thous. of tons	837.0#	834.0r	3.5
ELECTRICITY (8/13) millions of ft.	478.1#	481.9	8.3
TRUCKS (8/13) billions of ton-miles	24.2#	23.5	18.6

American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, Petroleum Institute, Energy Dept., American Paper Institute, WWPAA, SPPA, Association on Railroads

CURRENCY EXCHANGE

	Latest week	Week ago	Year ago
U.S. DOLLAR (8/24)	98	100	104
MARK (8/24)	1.54	1.56	1.67
POUND (8/24)	1.55	1.54	1.51
FRANC (8/24)	5.29	5.34	5.85
YEN (8/24)	1.38	1.38	1.32
FRANC (8/24)	1.30	1.31	1.47
PESO (8/24)	3.342	3.399	3.107

Major New York banks. Currencies expressed in units per U.S. dollar, except for British pounds in dollars

COMMODITIES

	Latest week	Week ago	% Change year ago
WHEAT (8/24) \$/bushel	383.900	377.200	3.4
RAP (8/23) #1 heavy, \$/ton	134.50	134.50	19.6
FFBS (8/23) index, 1967=100	214.6	214.5	1.8
COFFEE (8/20) c/lb.	112.9	112.4	24.9
WHEAT (8/20) c/lb.	71.0	70.0	30.9
WHEAT (8/20) #2 hard, \$/bu.	3.73	3.59	11.3
WHEAT (8/20) strict low middling 1-1/16 in., c/lb.	68.06	71.07	30.0

London Wednesday final setting, Chicago market, Knight-Ridder Commodity Research, Kansas City market, Memphis market

1a in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment
n Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

LEADING INDICATORS

	Latest week	Week ago	% Change year ago
STOCK PRICES (8/19) S&P 500	463.63	459.39	2.6
CORPORATE BOND YIELD, Aaa (8/19)	8.07%	8.12%	18.9
INDUSTRIAL MATERIALS PRICES (8/19)	105.9	104.6	11.1
BUSINESS FAILURES (8/12)	NA	287	NA
REAL ESTATE LOANS (8/10) billions	\$436.0	\$434.8	4.8
MONEY SUPPLY, M2 (8/8) billions	\$3,553.9	\$3,572.0r	2.0
INITIAL CLAIMS, UNEMPLOYMENT (8/6) thous.	324	315	-2.1

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of large companies), Federal Reserve, Labor Dept. CIBCR seasonally adjusts data on business failures and real estate loans

MONTHLY ECONOMIC INDICATORS

	Latest month	Month ago	% Change year ago
ORDERS FOR DURABLE GOODS: MFG. (July) billions	\$144.9	\$151.2r	12.8
BUDGET SURPLUS OR DEFICIT (-) (July) millions	-\$33,198	\$14,850r	NM
HOUSING STARTS (July) annual rate, thous.	1,415	1,351r	13.7
REAL GROSS WEEKLY PAY (July)	\$255.48	\$255.58	0.4

Sources: Commerce Dept., Treasury Dept., BLS

MONETARY INDICATORS

	Latest week	Week ago	% Change year ago
MONEY SUPPLY, M1 (8/8)	\$1,147.4	\$1,158.8r	5.2
BANKS' BUSINESS LOANS (8/10)	300.3	299.7r	9.5
FREE RESERVES (8/17)	421	917r	32.0
NONFINANCIAL COMMERCIAL PAPER (8/10)	150.5	154.2	-4.7

Sources: Federal Reserve (in billions, except for free reserves, which are expressed for a two-week period in millions)

MONEY MARKET RATES

	Latest week	Week ago	Year ago
FEDERAL FUNDS (8/23)	4.64%	4.35%	2.98%
PRIME (8/24)	7.75	7.75	6.00
COMMERCIAL PAPER 3-MONTH (8/23)	4.91	4.91	3.14
CERTIFICATES OF DEPOSIT 3-MONTH (8/24)	4.87	4.86	3.14
EURODOLLAR 3-MONTH (8/19)	4.85	4.76	3.13

Sources: Federal Reserve, First Boston

YOU'VE JUST MISSED THE FIRST SIGN OF BREAST CANCER IF YOU DIDN'T SEE THAT SMALL DOT IN THE UPPER LEFT HAND CORNER. Because it can start that small inside your breast. That's why a yearly mammogram is a must, especially if you're over 50. Doctors agree that as you get older, the risk of breast cancer is higher. But with early detection, you increase your chance of successful treatment. Even though you may have missed the first sign of breast cancer, a mammogram won't. For information, please call the American Cancer Society at 1-800-ACS-2345.

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EARLY DETECTION IS THE
BEST PROTECTION.**



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This Publication



Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

AirTouch 84
Alamo 88
Aldila 28
A.M. Best 75
Amerada Hess 76
American Airlines 62, 88
American Cyanamid 67
American Express 56, 88
American Management Systems 56
Arthur Andersen 48
Arthur D. Little 42
AST Research 18
AT&T 37, 56, 62, 80, 84
Atlanta Braves 6
Atlantic Records 78
Autofacts 31

B

BankAmerica 74
Bank Leumi Trust 90
Barnes & Noble 20
Barnett Banks 28
Bath Iron Works 29
Bell Atlantic 84
Blockbuster 34, 56
Blohm & Voss 29
Bloomingdale's 36
Boatmen's Bancshares 75
Boeing 80
Bojangles' 26
Box Energy 76
Bristol-Myers 67, 68
British Airways 56
British Telecom 84
Brookings Institution 6
Brown & Williamson 68

C

Caesars World 76
Call-Net Enterprises 84
CalPERS 10
Cargill 83
Caterpillar 35
CBS 20
CBS Records 78
Cellnet Data Systems 83
Cenit Seguros 75
Centel 84
Chase Manhattan 20, 74
Checkers Drive-In Restaurants 48
Chemical Banking 48
Chrysler 20, 28, 31
Citibank 37, 74
Claridge Hotel & Casino 56
Clay-Park Laboratories 67
Colt Industries 68
Columbia Pictures 34
Compaq 26, 38
CompuServe 18
ConAgra 83
Connor Clark 38
Continental Airlines 88
Coopers & Lybrand 26
Cray Research 62
Cross Rapp Associates 56
Crossland Savings 74
Culligan International 45
Customer Insight 62

D

Daishowa Paper 14
Dataquest 38
Dean Foods 42
Dean Witter Reynolds 20
Deloitte & Touche 36, 48, 52

Delta Air Lines 62, 88

Deutsche Bundespost

Telekom 84

Diner's Club 88

Discovery Zone 56

Donnelley Marketing 56

DRI Europe 44

Dun & Bradstreet 23

DuPont 35

E

Eastern Airlines 88
Eastman & Beaudine 6
Eastman Kodak 80
Electronic Data Systems 84
Eli Lilly 67, 68
Equifax 60
Ernst & Young 48

F

Ferruzzi-Montedison 68
Fiat 44
Fidelity Investments 20, 48, 75
Fingerhut 62
First Commerce 56
First Financial Bank 90
First National Bank of Omaha 90
Ford 26, 31, 37
France Telecom 84
Frequency Marketing 56
FTD 88
Furman Selz 34, 78

G

Garner Group 62
G.D. Searle 68
General Dynamics 28
Georgia Power 83
GM 28, 31, 44, 56, 80
Gold Strike Inn & Casino 76
Goldman Sachs 20
Green Gear Cycling 91
Greyhound Lines 38
Grunalt 67
Grupo Iusacell 84
GTE 84

H

Harley-Davidson 56
Harris 28
Hartford Life 75
Hasbro 20
Heilig-Meyers 48
Hewlett-Packard 62
Hilton Hotels 56
HNC Software 62
Honda 31
Howmet 83

I

IBM 38, 40, 62, 80
IMS America 67
Intel 26
ITT 75

J

J.C. Penney 36
J.W. Charles Securities 76

K

Kansas City Power & Light 83
Kendall Square Research 48
Kinney Aro 8
Kmart 8
KPMG Peat Marwick 48
Kraft General Foods 56

L

Landmark Funds 74
LDDS Communications 84
Lemmon 67
Levi Strauss 36
Linear Manufacturing 91
Lipper Analytical Services 74
Lockheed 29
Lorillard 68
Lotus Development 18

M

Magic Edge 8
Major League Baseball 23
Marathon Oil 76
Marion Merrell Dow 67, 68
Martin Marietta 28
Massachusetts Financial Services 34
MasterCard 56
McCaw Cellular Communications 20
McDonald's 38
McDonnell Douglas 28, 29
MCI 20, 56, 84, 88
McKesson 67
McKinsey 37
Medco 20
Medusa 26
Merck 20, 67, 68
Merrill Lynch 20, 84
Metromail 56
Metropolitan Life 75
Michelin Tire 37
Microsoft 18
Miles 28
Mirage Resorts 76
Mobil Oil 80
Monitor 26
Montague 91
Morgan Stanley 20
MTV 78
Mutual of New York 75
Mylan Laboratories 67

N

NAMCO 8
National Car Rental 88
National Demographics & Lifestyles 56
NationsBank 6
Nickelodeon 34
Nike 26
Nomura 26
North American Philips 35
Northern States Power 83
Northwest Airlines 88
Novell 18
Nynex 84

O

Olympus Asset Management 74
Oppenheimer 76, 84
Oracle 6
Overseas Private Investment 45

P

Pacific Telesis 84
PaineWebber 20
Paramount Communications 34
Pechiney 83
Pemex 42
Pfizer 28
Philip Morris 56, 68
Pillsbury 83
Placer Dome 76
Plainview Farms 68
Pratt & Whitney 83
Price Waterhouse 37, 48
Prodigy 18
Prudential Securities 20
Pyxis 48

Q

Quote.Com 18

R

Reebok 26
Regional Financial Associates 22
Renault 44
R.H. Wrightson & Associates 8
RJR Nabisco Holding R.L. Polk 56
Roche Holdings 67
Rugby-Darby 67

S

Safeway 20, 62
Salomon Brothers 75
Seagram 56
Sears 36
Seitel 48
S.G. Warburg 84
Shook, Hardy & Bost
Silicon Graphics 8
SmithKline Beecham
Sony 34
Sony Music Entertainment 78
SoundScan 78
Sprint 84
Standard & Poor's
Stone Container 20
Sun Microsystems
Syntex 67

T

Tandem Computers
Tele-Communications 34
Texas Instruments
Thinking Machines
Time Warner 20, 70
Towers Perrin 74
Trans Union 60
Travelers 75
T. Rowe Price 20
TRW 60
Twentieth Century Fox
Turner Broadcasting

U

Unisys 29
United Airlines 38
United Technologies
Upjohn 67, 68
USAir 88
USG 26
U.S. West 84

V

Value Line 20
Vengold 76
Viacom 20, 34
Vista Growth & Inc.
Fund 74
Vons 62

W

Wal-Mart 56, 62
Walt Disney 34
Warner Bros. Reco
Weyerhaeuser 26
Williams 84
WiTel 84
WordPerfect 18

Y

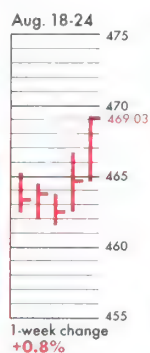
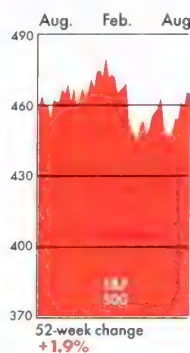
YAR Communication

Investment Figures of the Week

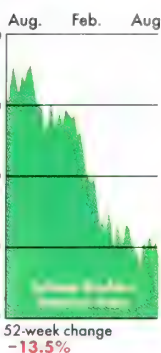
MARKET SUMMARY

Week in the financial markets: Stocks and bonds alike. Each day's economic weakness in the dollar pushed prices under pressure. Inflation news caused bond markets to drop. Recovery on Aug. 19 was cheered by word from Commerce Dept. that durable goods fell unexpectedly in July. The news bolting in London, where prices rose to their highest level in 1994.

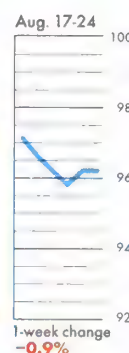
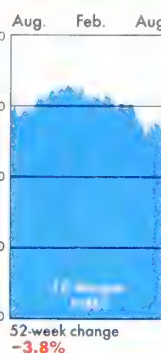
STOCKS



BONDS



THE DOLLAR



MARKET ANALYSIS

SECTORS	Latest	% change Week	% change 52-week
INDUSTRIALS	3846.7	1.9	5.3
COMPANIES (S&P MidCap Index)	175.8	0.6	1.3
COMPANIES (Russell 2000)	252.7	1.3	3.4
COMPANIES (Russell 3000)	269.4	0.9	1.5

STOCKS	Latest	% change (local currency) Week	% change 52-week
FINANCIAL TIMES 100	3205.2	0.5	4.1
Nikkei Index	20,511.6	-1.5	0.0
TSE Composite	4263.7	1.4	3.4

FUNDAMENTALS

	Latest	Week ago	Year ago
90-DAY TREASURY BILL YIELD	4.63%	4.68%	3.05%
30-YEAR TREASURY BOND YIELD	7.46%	7.39%	6.17%
S&P 500 DIVIDEND YIELD	2.71%	2.73%	2.72%
S&P 500 PRICE/EARNINGS RATIO	18.7	18.6	23.7

TECHNICAL INDICATORS	Latest	Week ago	Reading
S&P 500 200-day moving average	460.3	460.3	Positive
Stocks above 200-day moving average	39.0%	38.0%	Positive
Speculative sentiment: Put/call ratio	0.36	0.39	Neutral
Insider sentiment: Vickers sell/buy ratio	0.91	0.94	Positive

INDUSTRY GROUPS

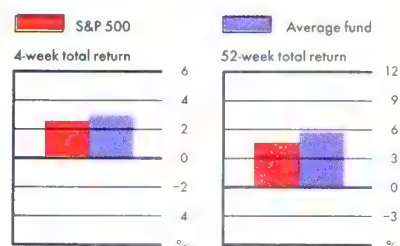
INDUSTRY LEADERS	% change 1-month	% change 12-month	Strongest stock in group	% change 1-month	% change 12-month	Price
MENTATION	15.5	16.8	HEWLETT-PACKARD	16.8	19.6	87 7/8
	14.1	11.4	ELI LILLY	17.0	18.9	55 7/8
CARE SERVICES	12.9	19.3	AMGEN	19.3	59.4	56
INICATIONS EQUIPMENT	12.6	4.9	SCIENTIFIC-ATLANTA	23.3	33.9	43
IFIED HEALTH CARE	12.0	13.1	AMERICAN CYANAMID	62.9	89.6	96 1/2

INDUSTRY LAGGARDS	% change 1-month	% change 12-month	Weakest stock in group	% change 1-month	% change 12-month	Price
D GAS DRILLING	-12.5	-27.1	ROWAN	-18.6	-29.6	7 1/8
LL EQUIPMENT AND SERVICES	-9.0	-18.4	HALLIBURTON	-15.3	-30.5	29 1/8
PLORATION AND PRODUCTION	-6.1	-25.6	MAXUS ENERGY	-11.4	-41.8	47 7/8
TIME	-5.6	24.5	BRUNSWICK	-8.9	46.7	22
S	-5.3	-16.9	USAIR GROUP	-13.6	-59.5	6 3/8

MUTUAL FUNDS

LAGGARDS	Four-week total return	%
STATE STREET RESEARCH GLOBAL ENERGY D	-6.9	
FIDELITY SELECT ENERGY SERVICE	-5.6	
INVESCO STRATEGIC ENERGY	-5.6	

LAGGARDS	52-week total return	%
MONITREND GOLD	-42.1	
KEYSTONE AMERICA HARTWELL EMERG. GR. B	-24.8	
AMERICAN HERITAGE	-24.5	



TOP PORTFOLIOS

Portfolios	Investment	Current Value	Change
Foreign stocks	\$10,000	\$11,819	+0.70%
U.S. stocks	\$10,000	\$10,389	-0.11%
Gold	\$10,000	\$10,275	+1.34%
Money market fund	\$10,000	\$10,203	+0.05%
Treasury bonds	\$10,000	\$9,320	-1.55%

This page is as of market close Wednesday, Aug. 24, 1994, unless otherwise indicated. Funds include S&P 500 companies only; performance and share prices are as of market close.

Aug. 23. Mutual fund returns are as of Aug. 19. Relative portfolios are valued as of Aug. 23. A more detailed explanation of this page is available on request. r = revised

THE NEXT STEP FOR A NEW MEXICO

The Mexican miracle continues to astonish. An amazing 77% of the people casting ballots voted center or center-right in the recent elections in a powerful reaffirmation of the economic policies of outgoing President Carlos Salinas de Gortari—free trade, privatization, low inflation, and the promise of growth.

But the people of Mexico did more than simply voice support for a continuation of the recent past. They gave the country's governing party a chance to do for the nation's polity what it has already done for its economy—modernize. By giving 27% of the vote to the National Action Party (PAN), which shares the promarket philosophy of the ruling Institutional Revolutionary Party (PRI) but is more conservative on social issues, the voters are signaling incoming President Ernesto Zedillo Ponce de León that they want political change.

This is how Zedillo can deliver: The President-elect should set up a government of national unity that includes PAN. He doesn't have to do it, of course. The PRI, with about a 50% majority of the vote, will probably control both houses of Congress. But power-sharing would be of immense benefit both to Zedillo and to Mexico. Never in the 65-year history of PRI rule has it shared political power. Now would be an ideal time to try it (page 42).

There are tactical benefits for Zedillo in asking PAN to join

his new government. *Panistas* share his vision of a new Mexico much more than the PRI's own "dinosaurs," traditional, old-fashioned bosses of the party. Together PAN, Zedillo can move to isolate the forces of political reaction within the PRI.

By bringing in PAN, Zedillo can also begin to "secularize" the Mexican government. Just as the Soviet Union was dominated by a Communist Party that held all government offices and, in effect, was the government, so, too, has the PRI been intertwined with Mexico's political apparatus. The result? Vast corruption in the police and judiciary, stymied economic development, and reduced personal freedoms.

Disentangling that relationship between the party and government is the next step in Mexico's march toward democracy. Politics and the polity have to be separated at the top, with the state emerging as an independent institution beholden to the voters, not just PRI politicians.

A government of national unity that included PAN members in the Cabinet would be a revolutionary step in the direction. It would give Zedillo tactical room to make moves against the PRI's Old Guard and would permit Mexico to take the strategic step of putting the law above political factions and the state above politics. It is up to President-elect Zedillo to begin to implement the politics of inclusion.

MARKETERS KNOW TOO MUCH ABOUT US

The invasion of privacy is proceeding at an alarming rate, with supercomputers recording and compiling every transaction in a person's life. These records of Americans' income, spending habits, and preferences are putting a growing amount of power into the hands of a few government bureaucrats and private marketers (page 60).

Are the data gatherers adequately policing themselves? The government, to begin with, is actively selling huge amounts of personal information to listmakers. Is it right for state motor-vehicle bureaus to sell the names and addresses of individuals who get driver's licenses? Is it proper for institutions such as hospitals to sell the names and addresses of women who just gave birth on their premises? Just how much financial information should credit agencies be permitted to sell?

It's not that database marketing hasn't any value. Clearly, it does. Customized billing can provide important information and opportunities to the consumer. Credit-card companies can offer discounts on specific restaurants for people who eat out a lot, and telephone companies can give people breaks on phone calls to countries where they have parents or brothers and sisters.

But what are the limits, and how do the rights of individuals get protected? It is increasingly easy for powerful computers to mix and match profile traits of individuals, reach

erroneous conclusions, and mistakenly put consumers on a wrong list. Once they are on that list, it is certain their names will appear on dozens of others, targeting them for products and services that may prove annoying, embarrassing, or threatening to themselves or their families.

Congress can help by passing legislation that tells government agencies, hospitals, and any quasipublic institution simply stop selling data about people unless individual agencies specifically permit it in writing. Who gave government agencies the right to cash in on information that people are forced to give them in the first place?

The direct-marketing industry can help by lifting its standards. It currently relies largely on the "opt-out" provision to protect individual rights. This is the clause that sometimes appears at the bottom of documents that says "I am here" if a person does not want his or her name passed on. Fair enough, except that the print is invariably small. The provision, when it appears, is usually buried far from the way.

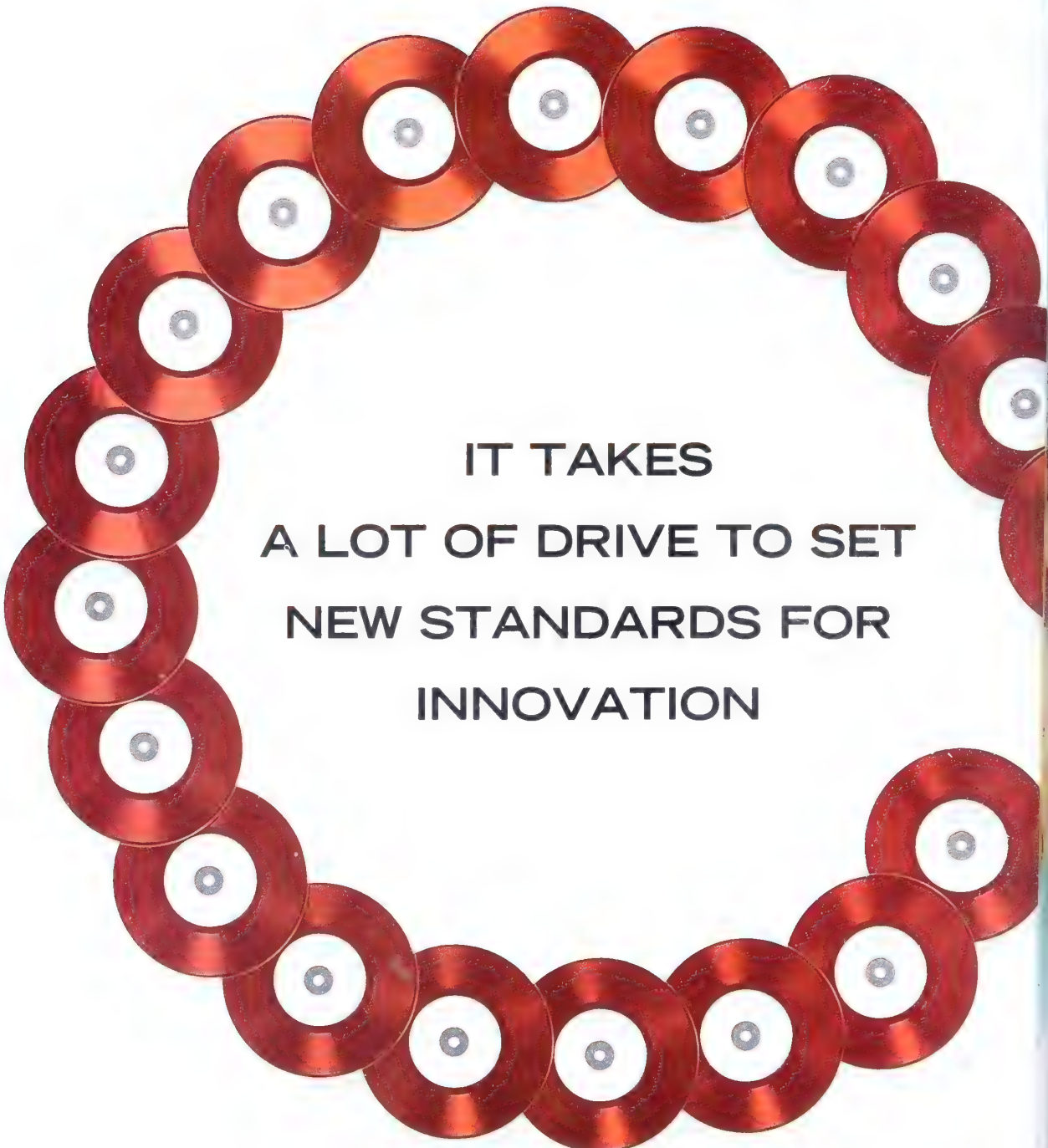
The Direct Marketing Assn. should insist that its members give people a real choice by making the opt-out provision clear and prominently displayed at the top of all private documents. The DMA maintains that consumers who want to get their names off mailing lists merely have to phone them. Here's the number: 202 347-1222. Too bad it's not toll-free.

Pardon us
while we
annihilate
a few old
notions.



ather was a Cruise Missile. Its mother was a concert hall. And it's three parts power, two parts elegance, and all parts incredible. It's the
32-valve, 250hp, DOHC V8 Aurora by Oldsmobile. But if you feel more comfortable calling it a luxury-performance sedan, go right
ad. Aurora by Oldsmobile. See what happens when you Demand Better. Call 1-800-718-7778.

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55 WEEK
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THE ECONOMICS OF AGING

PAGE 60



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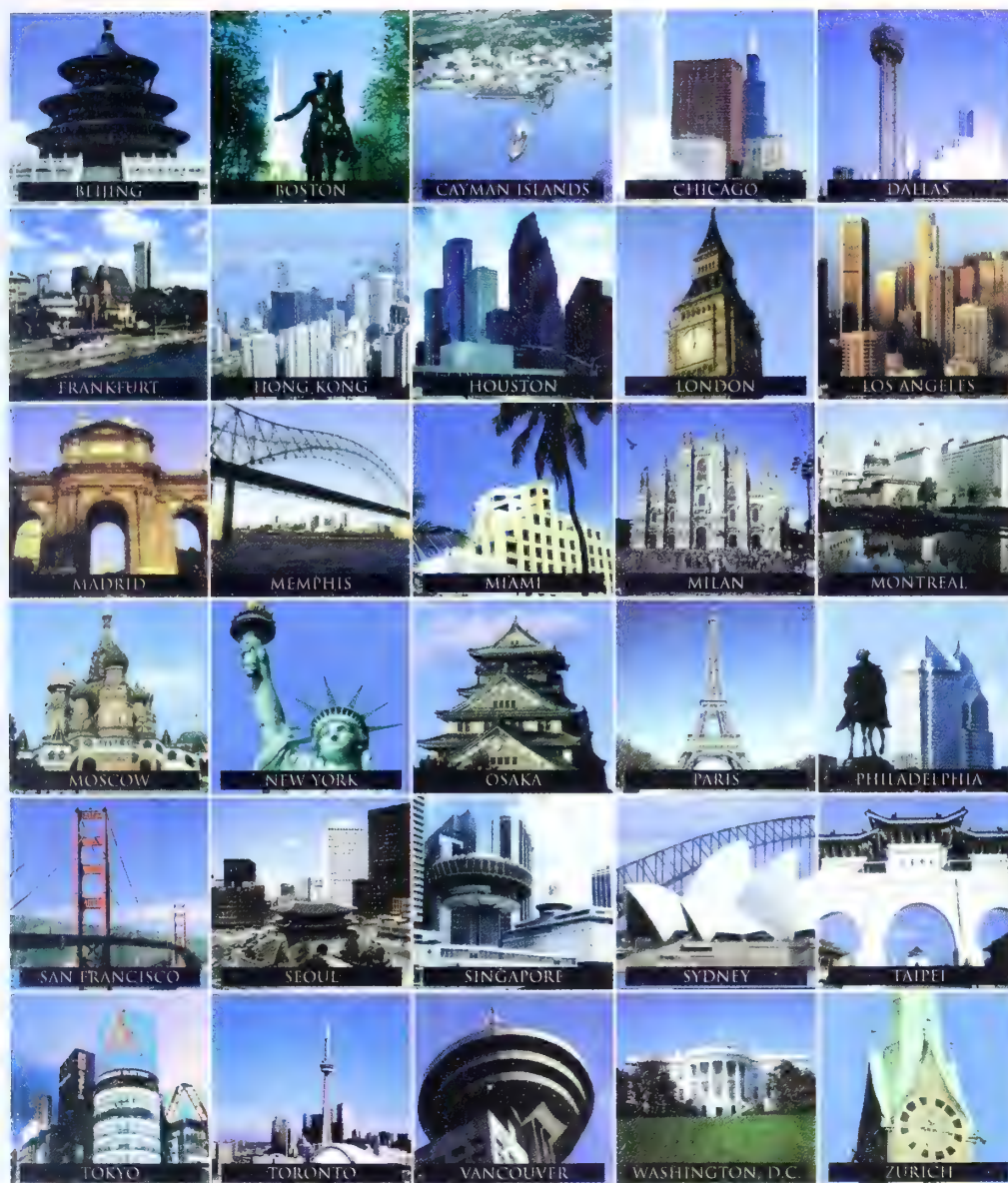


IN 125 YEARS SINCE WE BEGAN ON PINE STREET, OUR VIEW HAS CHANGED

We've grown since Marcus Goldman first opened an office in New York City – from a small provider of short-term credit to local businesses, to a full-service firm



with a global perspective. Today, Goldman Sachs is nearly 9,000 strong, employing people from 91 countries in 30 offices around the world. We are recognized as



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 range of financing, investing and financial
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institutions, governments and individuals
 worldwide. We make these resources
 readily available to meet our clients' needs
 around the clock and around the globe.



AN ECONOMIC LIFT? NEW ZEST FOR FITNESS IS MAKING IT POSSIBLE FOR MANY SENIOR CITIZENS TO STAY PRODUCTIVE LONGER

Cover Story

60 THE ECONOMICS OF AGING

Americans are getting older. For many, that raises the specter of economic decline, out-of-control health costs, and a bankrupt Social Security system. But a number of factors—among them rising productivity, healthier lifestyles, and new waves of immigration—suggest that the graying of America will be an economic asset, not a burden

66 THE LONG HAUL LOOKS GOOD

Why investors needn't fear the march of time

Top of the News

30 MERGE NOW, PAY LATER?

The wave that's sweeping every major industry may look like the '80s, but it's a whole new deal

32 CALL IT LOCKHEED MARTIN

The new defense contractor has the competition shell-shocked

33 IS JACK WELCH SEEING GREEN?

General Electric is pondering a takeover of American Express

33 WINGING ON WALL STREET

The Dow's summer rally won't bring stampeding bulls or a sudden swoon

34 BAD CONNECTION FOR MCI

It's hanging up on a deal with Nextel because of technical flaws

35 SMITHKLINE'S NEW WORLD ORDER

Sterling gives the drug giant a major franchise in Europe and Asia

38 COMMENTARY

A little Keynesian job creation wouldn't throw the Fed off course

40 SONY AMERICA'S SAVIOR?

Jeff Sagansky helped turn CBS around. This job's even tougher

42 WILL WORK FOR ZILLIONS

Katzenberg, Geffen, and Diller pound the pavements

46 IN BUSINESS THIS WEEK

RTC, Madison Square Garden, Scott Paper, Boston rebound, Zenith/IVAX, Borland's chairman, the Hafts

International Business

52 EUROPE

The Continent's big media companies rush into each other's arms to gain strength in a growing market

54 CHINA

Ron Brown's happy visit to Beijing produces billions in deals and a gesture on human rights

56 INTERNATIONAL OUTLOOK

Castro just might reach for the ivy branch

Economic Analysis

22 ECONOMIC VIEWPOINT

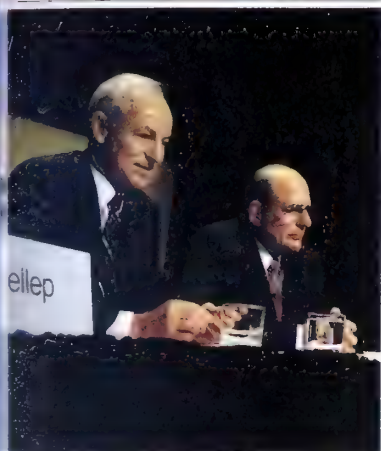
Becker: Yes, homelessness is a growing problem in U.S. cities, but the "crisis" is mostly hype

26 ECONOMIC TRENDS

Japan Inc.'s push in Asia, rainy-day shopping, limping stocks, the impact of public works on productivity

27 BUSINESS OUTLOOK

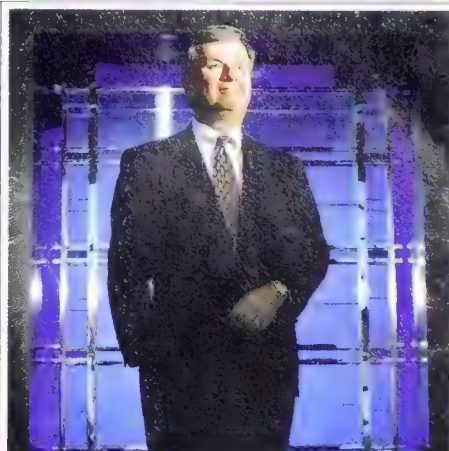
Don't let the third quarter scare you. Growth is down, but not o



ARMS AND THE MEN: LOCKHEED'S DANIEL TELLEP AND MARTIN MARIETTA'S NORMAN AUGUSTINE HAVE UNCORKED A MERGER THAT HAS RIVALS REELING



80 CHANGE SEX, CHANGE THE PAST: BEFORE BECOMING PRINTRON CEO AS ELEANOR SCHULER, JOHN HUMINIK JR. RAN TWO COMPANIES THE SEC ACCUSED OF FRAUD. WHO KNEW?



74 THE SIZZLE AT SPIEGEL: WITH A REVAMPED CATALOG AND PURCHASE OF THE POPULAR EDDIE BAUER CHAIN, CEO JOHN SHEA HAS REVITALIZED THE RETAILER

Government

WASHINGTON OUTLOOK

Slash-and-burn artist Phil Gramm is off on a fiery quest for the White House

CLINTON COZIES UP TO BUSINESS

Corporate gifts to the DNC have reached a record \$60 million—about 75% from big donors

Corporation

EUROPE

A slow boil for ABB's U.S. unit—but a new boss is turning up the heat to power a turnaround

SPiegel's NEW LOOK

Catalog sales and expansion at its Eddie Bauer chain are fueling momentum as other retailers slump

Science & Technology

ARTIFICIAL BONES

New bioceramic materials could grab a chunk of the \$2 billion market for medical grafts and implants

DEVELOPMENTS TO WATCH

Foiling burglars, synfuel advances, less nuclear waste, more PC video, robotic insects

Finance

A BLIND EYE AT AMEX?

The bizarre Printron case shows how the exchange too often ignores the most glaring signs of trouble

83 LBO HOT-RODDERS RETOOL

Firms are looking for deals in unlikely places and pursuing a variety of new strategies

86 INSIDE WALL STREET

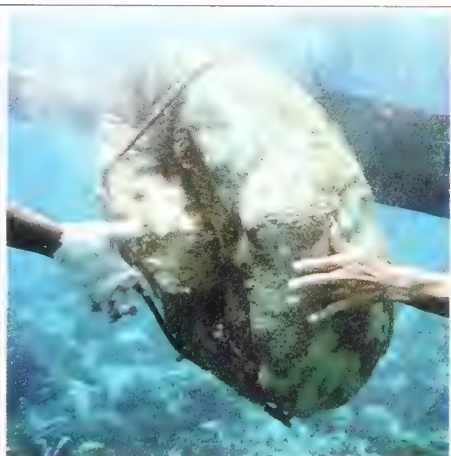
Time Warner: Magazine sale? Tridex may win the lottery order An Iceberg that just might sink

105 INVESTMENT FIGURES OF THE WEEK

Information Processing

20 TECHNOLOGY AND YOU

Pocket Quicken: A balm for the expense-account blues



76 A BOOM IN BIO-CERAMICS: MINERALIZED CORAL IS ONE OF SEVERAL NEW MATERIALS USED FOR GRAFTS AND IMPLANTS—AND THE POTENTIAL MARKET IS KING-SIZE

88 A SECOND COMING FOR PDAs

New personal digital assistants from BellSouth, Motorola, and Sony have learned from Newton's mistakes

90 TELECOM'S NEW TITAN

Now that LDDS is a big-leaguer, it's looking good to other predators

92 TELEFONICA'S OVERSEAS CALL

Spain's phone giant is snapping up properties in Latin America

Sports Business

96 MARKETER WITH A MEAN CURVE

Clarion, a promoter of sport-sponsor tie-ins, is coming on strong

Personal Business

98 MUTUAL FUNDS: Trustworthy?

MUSIC: Classical for kids

AUTOS: Low-priced luxury cars

Features

6 UP FRONT

12 READERS REPORT

12 CORRECTIONS & CLARIFICATIONS

18 BOOKS

Hilfiker: *Not All of Us Are Saints: A Doctor's Journey with the Poor*

103 BUSINESS WEEK INDEX

104 INDEX TO COMPANIES

106 EDITORIALS

Cuba doesn't rate a China-style thaw
Let the boomers build nest eggs
Consolidation could get out of hand

Up Front

TALK SHOW

Sports and music are things that I think everybody should have.

—Luciano Pavarotti, at the Aug. 30 launch of "Pavarotti's Oper Made Easy," a series of recordings aimed at the mass market

EDITED BY LARRY LIGHT AND JULIE TILSNER

OLYMPICS '96

BILLBOARDS STINK— UNLESS THEY'RE YOURS

Atlanta's Olympic Committee doesn't want any ugly billboards around for the 1996 Summer Games—unless the Olympics benefits. The group is backing plans to erect 50 "super signs" in downtown Atlanta, each higher than a nine-story building, to peddle the wares of Olympic sponsors and others. Irony: The committee recently helped write a 76-page city law banning new outdoor advertising and other "visual pollution" before the extravaganza. Already, the committee has unveiled its tasteful

banners, which will be ubiquitous in 1996.

When a billboard company this summer trimmed trees downtown that were blocking its signs, committee members protested this aesthetic affront. And the group helped force one of its own sponsors, Sara Lee, to black out billboards, costing \$900,000, near the Olympic Stadium during the games.

But the Olympian standards fall when it comes to the super signs, which the



BANNER YEAR: Atlanta battles "visual pollution"

city council is expected to O.K. "We are already one of the most billboard-inundated cities in the country," complains city Planning Commissioner Leon Eplan, who nonetheless backs the super-sign plan.

The committee says there is no contradiction: The signs will have to impart an Olympic-related "activity or principle." And commercial messages would be limited to one-fifth of the space on each sign. That's "only" a 22-foot-by-8-foot space. David Greising

RED FACES

ELAINE GARZARELLI'S BRUSH WITH THE LAW

Elaine Garzarelli has nabbed for drunk driving. Police say they arrested the vaunted stock seer at 5 a.m. on Aug. 19 in tony Hampton, N.Y., after she drove through some sherry as she turned a corner. Even though a squad car followed her with lights flashing, police say she continued down the street, which earned her citation for leaving the scene of an accident.

Lehman Brothers strategist Garzarelli, 46, says she was driving a gentleman friend home after a night of champagne at her East Hampton home. "I thought I was to drive," says Garzarelli. She was surprised when the test revealed her blood/alcohol level as 0.18 (legal limit 0.1). She said she kept driving because she didn't realize police wanted her to stop. She spent several hours in a clinic, then posted \$300. A court date is pending.



MAD AVE

HAVE YOU HUGGED YOUR ADVERTISER TODAY?

Magazine publisher Condé Nast, stung when Delta Air Lines yanked its ads from *Condé Nast Traveler* after a negative story, may make up

based carrier just pulled the remaining \$95,000 in its \$350,000 1994 ad budget for the mag. A Delta spokesman denies that the move is retribution, calling it a needed trimming of its ad budget.

At Hearst's *Esquire*, the September edition portrays Patricia Duff, Democrat activist and girlfriend of Revlon Chairman Ron Perelman, as a relentless social climber—

"part Pamela Harriman, part Mata Hari." Now, Revlon is pulling \$5 million in advertising from Hearst. Revlon officials say the reason is unhappiness over where Hearst placed the ads, not the Duff story.

Condé Nast, whose mags include *Vogue* and *Mademoiselle*, says Revlon would feel welcome. "Mr. Perelman would not have a problem with our airport maintenance pieces," says Condé Nast's Beckman. Christina Del Valle



RUFFLED FEATHERS: Hearst's loss could be Condé Nast's gain

the diff thanks to a similar tiff between Hearst Magazines and Revlon. Cosmetics giant Revlon is considering shunting to Condé Nast ad dollars it pulled from Hearst.

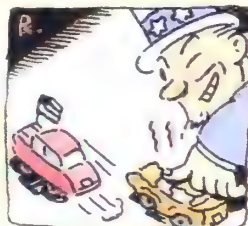
In the August *Traveler*, the magazine identified Delta as leading the list of airlines fined by the Federal Aviation Administration for maintenance violations, accruing more than \$2 million in penalties from 1986 to 1994. *Traveler* publisher Richard Beckman says that's why the Atlanta-

REALITY CHECK

CAR DOMESTIC-CONTENT LABELS

will make it easier to "buy American," say U.S. auto execs. The federally mandated labels, on new cars as of Oct. 1, list what percentage of parts are U.S. or Canadian, the topmost foreign coun-

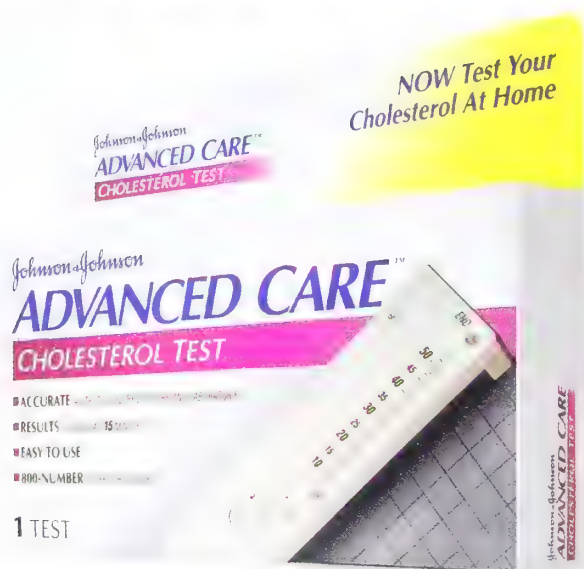
tries supplying parts, the country the engine transmission parts come from, and where the car was assembled. Detroit says foreigners balk at wink U.S. buyers into thinking a car is North American-made when most of its parts come from abroad.



IN REALITY, the rules are severely skewed to make Detroit look good and everyone else look bad. Because only parts are tallied—not labor—the wages paid to American workers in Japanese-transplant operations aren't counted. Moreover, the formula for identifying a part as domestic is so arbitrary that the same car could

carry a label showing homegrown content as high as 53% or as low as 11%, according to the National Highway Traffic Safety Administration. Reason: rounding up or down. A part whose components are 70% domestic gets rounded to 100% homegrown. If it's only 69% domestic, it counts as 0%. James B. Tie

NO APPOINTMENT NEEDED



For advice on dealing with cholesterol, make an appointment with your doctor. To simply know your cholesterol number, there's no appointment needed. Introducing the Johnson & Johnson ADVANCED CARETM Cholesterol Test. Each test can be used once to measure your cholesterol. And in about 15 minutes at home you'll get results as accurate as tests used by doctors and laboratories. There's no easier way to know your number.

**THE CHOLESTEROL TEST AS ACCURATE AS THOSE
USED BY DOCTORS AND LABORATORIES.**

FOOD FORAYS

PIZZA HUT: OUT TO TEMPT THE ITALIANS

Coals to Newcastle, pizza to Parma. That's the gamble Pizza Hut is taking, aiming to sell its pies to the Italians, who invented the stuff. Wichi-



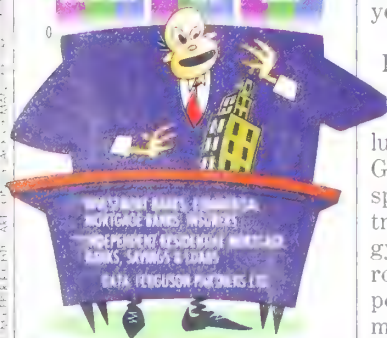
CRUST CLASH: Some like it thin

ta-based Pizza Hut plans to open by yearend its first Italian franchise, on Piazza Picelli in Parma's historical center, and later to expand through-

THE BIG PICTURE

REAL ESTATE FINANCIERS RIDE AGAIN

Want to get a job in real estate finance? The real estate slump of the early 1990s made that tough for a while. But there has been a turnaround lately. Hiring in institutions that finance big property transactions is on the upswing. For mortgage lenders, though, this year's rising interest rates have slowed new hires.



FOOTNOTES

out Italy. Already, Pizza Hut is in 88 other countries.

The company admits Parma will be a litmus test. The home of prosciutto and Parmesan cheese, this city is known for its discriminating tastes, both gastronomical and otherwise. Parma is where internationally renowned opera stars get booed right off the stage. Pizza Hut spokesman Robert Doughty contends that the chain will overcome resistance by adopting the decor of an Italian café and tailoring the menu to Italian tastes. "In Japan, for example, we offer pizza with squid."

Trouble is, company menu planners have yet to come up with a strategy to rival the Italian pie. Faith Heller Willinger, a food-service expert in Florence, says Pizza Hut's famous thick, doughy crust laden with cheese and pepperoni won't appeal to Italians, who prefer a thin, crispy crust and spare toppings.

Beyond that, the question turns on whether Italians will see Pizza Hut as homogenized fast food, which they dislike. But Romeo Medici, director of statistics research at Parma's Chamber of Commerce, says convenience and cheap prices work in Pizza Hut's favor. Italy, too, he says, is "becoming a culture of mass consumption." *Christina Bennett*

TOURIST TREKS

GUESS WHOSE LIBRARY IS A SNORE

As the summer tourism season winds down, consider Presidential libraries. Dull places, reserved for scholars and worshippers of former Chief Executives? Sometimes yes, sometimes no.

Take the three-year-old Ronald Reagan Presidential Library in Simi Valley, Calif. Eager to lure a few tourists for the Gipper, the center just sponsored a high-tech trade show. The Technology Exposition on Tomorrow's California, or "Texpo," was billed as promoting "appreciation of the

DRAWN AND QUARTERED



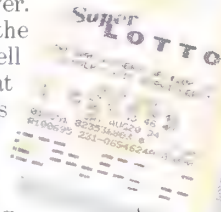
PRODUCT PEEK

HIT THE JACKPOT? YEAH, YOU AND WHO ELSE?

For those who would like to pool their chances at winning the state lottery but don't have a bowling team or bridge club to go in with, an outfit named National Pools has an answer.

For \$2.95, the company will sell you 100 chances at winning California's twice-weekly Super Lotto, whose pot had reached \$20 million by Aug.

31. The catch: A winner has to split the prize with 99 other ticket holders in the pool. Of the \$2.95, \$1 goes to buy a ticket, the rest to National



Pools. CEO Joseph Montero says the pooling program, which started in San Diego earlier this summer, eventually will go statewide. He hopes to get 1% of the California Lotto market and \$11 million in yearly revenue. Next, he wants to pool lottery players in 37 other states.

The strategy will make P.T. num proud: the odds of winning a big jackpot, whether solo or in a pool, are infinitesimal. Montero suggests that a pool can enhance your chances. State officials are examining the legality of the concept. So far, the lone National Pools win has snagged \$105. *Russell M...*

cial effects. Cost: just \$4 for adults, \$2 for kids. During Aug. 26-28 run, the library attracted 2,300 visitors, one of its biggest weekends ever.

But at the Richard Nixon Library & Birthplace in Yorba Linda, Calif., the crowds were absent. For \$4.95, through Sept. 6, you can catch an exhibit of Presidential neckties, featuring 35 colorful ties, fashionable links, stylish tie bars, and other accessories, reaching 200 years of Presidential taste." There's Jefferson's ascot, Lincoln's tie, and the red-and-green number Bill Clinton wore while playing the saxophone with Boris Yeltsin. *Ron G...*



EX-CHIEFS: Reagan's library offered Hollywood high tech, Nixon's has neckties



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YOU WOULDN'T BUY A CHEAP PACEMAKER.

YOU WOULDN'T BUY A CHEAP CRASH HELMET.

LET'S DISCUSS CARS.

There are some things in life that are simply too important to scrimp on. And yet every day, people do exactly that when choosing the one piece of equipment statistically most likely to determine their fate—their car. ¶ Despite clear evidence



to the contrary, many people still think of their car more as a fashion accessory than a serious piece of life-saving equipment. ¶ Fortunately, this attitude has never been fashionable at Mercedes-Benz. ¶ Which is why in every category that the government has set technical standards for safety, Mercedes-Benz automobiles not only meet them, but in many cases exceed them. ¶ And why in categories which the government does not require a standard, we have created our own. For instance, the government sets no standard for occupied seats absorbing rear impacts. But to pass the Mercedes-Benz standard, our occupied front seats must withstand a 30 mph car-to-car rear impact. ¶ Is there a less expensive way to build cars? To be sure. Is there a better way? If there is, you can be sure we will find it. ¶ Ultimately, the question you must ask yourself is not whether you can afford to buy a car built as well as a Mercedes-Benz. The question you must ask yourself is whether you can afford not to. ¶ If we can assist you in any way, please call 1-800-FOR-MERCEDES.





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IS MARKET TIMING JUST A CRAPSHOOT?

It is interesting to note that Jeremy J. Siegel's new book, *Stocks For The Long Run*, was reviewed in the same issue of BUSINESS WEEK as your article entitled "Time for market timers to get some respect?" (Finance, Aug. 22). Market timers, while enjoying recent success, don't have to be wrong often to lose much of the benefit of investing.

If, as some studies have shown, it is true that a significant portion of investment gains occur during a relatively few days, then picking the right days becomes more like a lottery than a prudent investment program.

William M. Francavilla
Resident Vice-President
Legg Mason Wood Walker Inc.
Williamsburg, Va.

CHRIS WHITTLE'S DEMISE: SURPRISE, SURPRISE

It saddened me to read of Chris Whittle's troubles in your article "Is this the last hurrah for Chris Whittle?" (Media, Aug. 22). But his demise is not surprising. After all, most of his ideas were terrible. (Channel One was a blatant attempt to bring advertising into the classroom by bribing poorer school districts with technology.) And the stream of falsified information (such as the readership data on Special Reports) was a telling indication that all was quite unwell.

What is disheartening is the lack of sound judgment displayed by his employees and backers. You quoted a friend of Whittle: "Chris has once again demonstrated his superb salesmanship." But as every salesman worth his salt knows, you must have something of value, and you have to back up your promises.

Scott Walsh
Brooklyn, N.Y.

JUST A SPEEDIER WAY TO DO A DUMB JOB?

Neat idea? Sure. Right idea? Not hardly. The "job evaluator" software programs reviewed in "So you hate

CORRECTIONS & CLARIFICATION

An item on Hasbro Inc.'s announced restructuring (In Business This Week, Aug. 29) incorrectly reported the number of planned U.S. layoffs. The company will lay off 100 workers.

In "Managing by values" (Cover Story, Aug. 1) Levi Strauss & Co. said contract garment workers in Bangladesh are paid \$384 a month. Levi's says these workers actually earn an average of only \$50 a month, including overtime pay. The \$384 figure is based on a formula known as Purchasing Power Parity that reflects the purchasing power of the U.S. dollar in Bangladesh and is meant, Levi's says, to "give some context to the wages paid in different countries."

The table with "Affordable insurance that works when you can't" (Personal Finance, Aug. 29) should have identified the premiums quoted as annual, not monthly.

"A splitting headache from a healthcare merger" (The Corporation, Aug. 22) incorrectly identified Christopher Lewis as a partner in the law firm Riordan & McKinzie. In fact, Lewis is a partner in the venture-capital firm Riordan, Lewis & Hayden. Los Angeles Mayor Richard J. Riordan is a founder of both firms.

rating your workers?" (Technology, Aug. 8) are nothing more than attractive high-tech mask over the face of an enduring business-as-usual problem.

Corporate America takes the trouble to build elegant performance-evaluation systems to support other human resource activities such as promotion incentives. Unfortunately, performance evaluations miss the mark on several counts.

The evaluations ask us to be that we are able to assess performance in the absence of personal bias. A little feedback performance evaluation provides occurs long after the point

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Ove Mattsson, member Board of Management Akzo Nobel, previously President Nobel Industries:

and soul

professional ambitions and we share the same
neural spirit. We fit both in body and soul.
is what it takes to create the right chemistry."

CREATING THE RIGHT CHEMISTRY



AKZO NOBEL

Readers Report

which it can be of any value to the employee.

True, the new software programs highlighted in your article will certainly make the process of preparing a performance appraisal somewhat less onerous. Eventually, however, we all need to recognize that human performance must have frequent, focused, and meaningful feedback in order for it to thrive and grow.

Jeff Anthony
President
Anthony Consulting
Hampton, Va.

DON'T LIKE "INFOBAHN"? HOW ABOUT "INFOSTRADA"?

Your articles often tend to use "Infobahn" as a synonym for the Information Highway ("Infobahn Warrior," Science & Technology, Aug. 8). The German name does not sound nice. It recalls the military applications of the autobahn developed by Hitler in the 1930s. I would like to offer another name that sounds much more intriguing: "Infostrada." *La strada* is an Italian term for a highway.

It even has some historic roots, since

in 1972, the first Infostrada was set up in Poland between Gdansk-Warsaw-Katowice with the collaboration of Singer Business Machines. Since the totalitarian regime could not allow for the horizontal flow of information, the project has been killed.

The Infostrada name is nice and more "spiritual" than Infobahn. This name also happens to be reminiscent of a beautiful movie with Anthony Quinn and Julietta Massina.

Andrew S. Targowski
Professor of Computer Information
Systems
Western Michigan University
Kalamazoo, Mich.

LET THE "INVISIBLE HAND" CAP BALL PLAYERS' PAY

The baseball strike in the U.S. ("Ste-e-e-riker?", Top of the News News, Aug. 15) pits the owners of the teams against the players over what amounts to wage controls.

The U.S., however, is supposed to be the place where the free-market principle runs proud. If the baseball experts are correct, then Adam Smith's "invisible hand" would ensure that fair-market con-

ditions would be found without limitations such as salary caps.

Let the ballplayers shop for their offer, and let the fans decide if the price is right. And let the Indians finally come home.

P.S. Even a baseball fan living at the base of the German Alps knows John Olerud, the man who flirted with .400 in 1993, is the first baseman for Toronto and not an outfielder. Ste-e-e-riker 1.

Mark
Mu

HOW TO REACH BUSINESS WEEK

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The 1994 Vimy's maiden flight July 30th, 1994 at 1910 hours, Hamilton Air Force Base, Novato, California.

Nothing is possible when people give wings to a dream. The enormous biplane pictured here is a replica of the 1919 Vickers Vimy. The original was the first airplane to fly halfway across the world England to Australia.

That record-breaking flight, piloted by Australian brothers, Ross and Keith Smith, demonstrated that the points of the earth could be brought closer by airplane. The brothers overcame harsh elements and difficulties with logistics to complete their epic in 27 days.

Anyone who travels by air is indebted to Ross and Keith Smith, whose skill and courage silenced the skeptics of their day. And because they dared to leave their footprints on the path of discovery, Americans would one day be emboldened to leave their footprints on the face of the moon. The names of Ross and Keith Smith rightfully belong alongside such men as Columbus, Captain America, and Apollo astronauts.

This year, to honor the 75th anniversary of that historic achievement, another Vimy built in America and Australia will be flown along the original route. The project, called VIMY 19/94, is being taken by two young adventurers, Peter McMillan and Lang Kidby, who are investing their own money and putting their lives on the line as a tribute to the pioneers before them. And like their forerunners, McMillan and

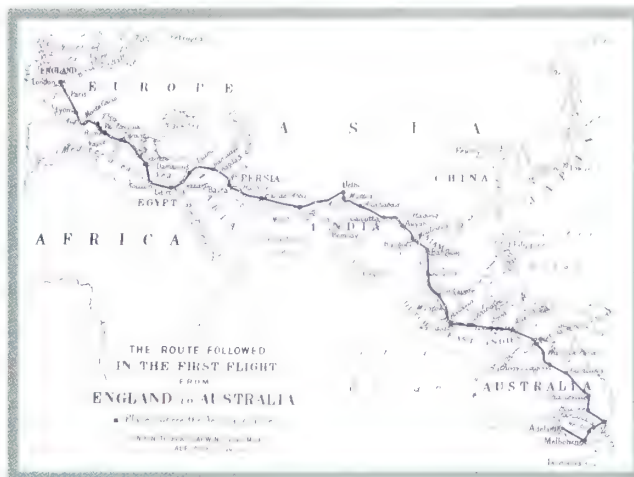
Kidby are confident of success. They believe in each other and have tried and trust their equipment. They need no other indemnity.

They have built the aircraft by hand from the original blueprints with a small team of dedicated craftsmen, but with little outside funding.

When people see the Vimy fly, in person or through the documentary coverage by the National Geographic Society (who published the first account of the 1919 Vimy flight), they will feel a renewed sense of adventure. But we hope they will also pause to consider the daring and determination that make such achievements possible. It is only this individual initiative and the willingness to take great risks that brings about advancement and discoveries in any field.

The VIMY 19/94 project is a not for profit organization and has been enthusiastically supported by the organizations below. But, if you or your company believes in strengthening the Vimy spirit and ideals, please call Vimy U.S. c/o Bittner & Company, 425 Market Street, San Francisco, CA 94105 at (415) 495-5105 or Vimy U.K. c/o The Brooklands Museum, Brooklands Rd., Weybridge Surrey KT13 OQN England at (0932) 857 381, ext. 231.

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VIMY 19/94



NOT ALL OF US ARE SAINTS: A DOCTOR'S JOURNEY WITH THE POOR

By David Hilfiker

Hill & Wang • 259pp • \$20

**BROKEN LIVES,
TATTERED SAFETY NET**

In the space of remarkably few years, David Hilfiker contends, there has been an abrupt and distressing turn in our relationship with the poor. Numbed, even overwhelmed by poverty's sheer scale, we have moved from denial to hopelessness "without ever passing through that intermediate stage when personal or political indignation might lead to action."

I don't know. I suspect many of us simply remain comfortably untouched by poverty. It's far less troubling, after all, to believe that the poor citizens of a wealthy nation are not treated poorly—that our taxes and charitable bucks provide an ever-widening safety net. Surely, we must be caring for these people.

That the net isn't catching everyone is made clear in Hilfiker's *Not All of Us Are Saints: A Doctor's Journey with the*

Poor. Out falls Leroy Solten, treated in an emergency room for his third bout with tuberculosis, then released to a crowded homeless shelter with only haphazard follow-up care. Walter McRae, homeless and an alcoholic, has his broken jaw wired shut and is discharged; unable to eat, he is found weeks later on the street, severely dehydrated and unconscious.

Hilfiker's is a stunning book for those exhausted by the health-care debate. It returns us, relentlessly and compellingly, to the problem that begot mandates, alliances, premium caps, and the rest: Many Americans don't receive decent medical care.

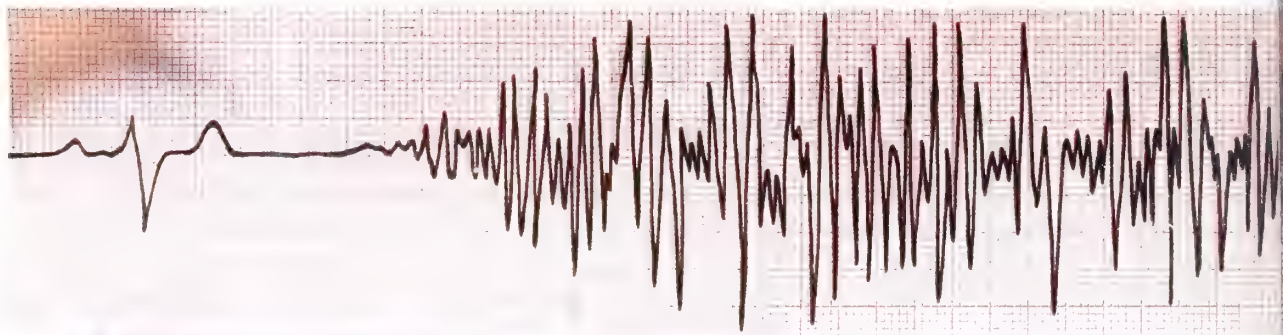
In 1983, Hilfiker left his rural medical practice in Minnesota, the setting of his 1985 book, *Healing the Wounds*. He moved to inner-city Washington to work

at a small, church-sponsored clinic—ad, eventually, to found a recovery shelter for homeless men needing care between the hospital and the street.

Not All of Us Are Saints catalogs the urban desperation he discovered—the alcoholics and drug addicts, the battered and the delusional. There is the woman who suffers from outrageously high blood pressure, living with her child in an abandoned tenement, seeking medication that she never takes for more than a few days at a time. There is the man who throws himself drunkenly before an automobile, then refuses psychiatric care.

These people are, of course, exceptional, and Hilfiker admits as much. Most of our poor lead lives considerably less dramatic than that of the dying or armed heroin dealer Hilfiker portrays. But their lack of glamour, for want of a better word, doesn't make it any easier for them to get food, housing, and a doctor's care. Welfare and public-assistance payments don't make anyone rich and in any case, like Medicaid reimbursements, they have been declining. Low-income housing initiatives have dropped off dramatically.

And for Americans without money,

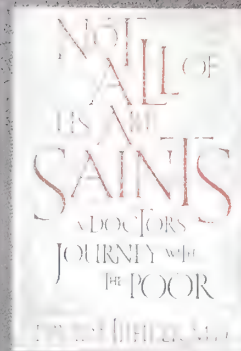


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the health-care system doesn't work very well. Those who qualify for Medicaid may be better off than the working poor without insurance. But both groups tend to get shunted from one care provider to the next. The apparatus that delivers poverty medicine is obnoxiously bureaucratic, underfunded, and overwhelmed. Increasingly—though not conclusively—studies suggest that people on Medicaid or without insurance enter hospitals sicker than those who can pay, leave sicker, and get inferior treatment.

Would health-care reform make a difference? Not the way Congress is shredding it now. And even in their purest form, "the Administration's proposals are likely to have little impact on the care available to the poor," Hilfiker says. To treat these people, we must address transportation, housing, and education needs; often, we must overcome generations of neglect and family dysfunction. Even when we acknowledge the inferiority of care for the poor, it is tempt-

A doctor's moving account of the urban poor—and the failure of the health-care system in the U.S.

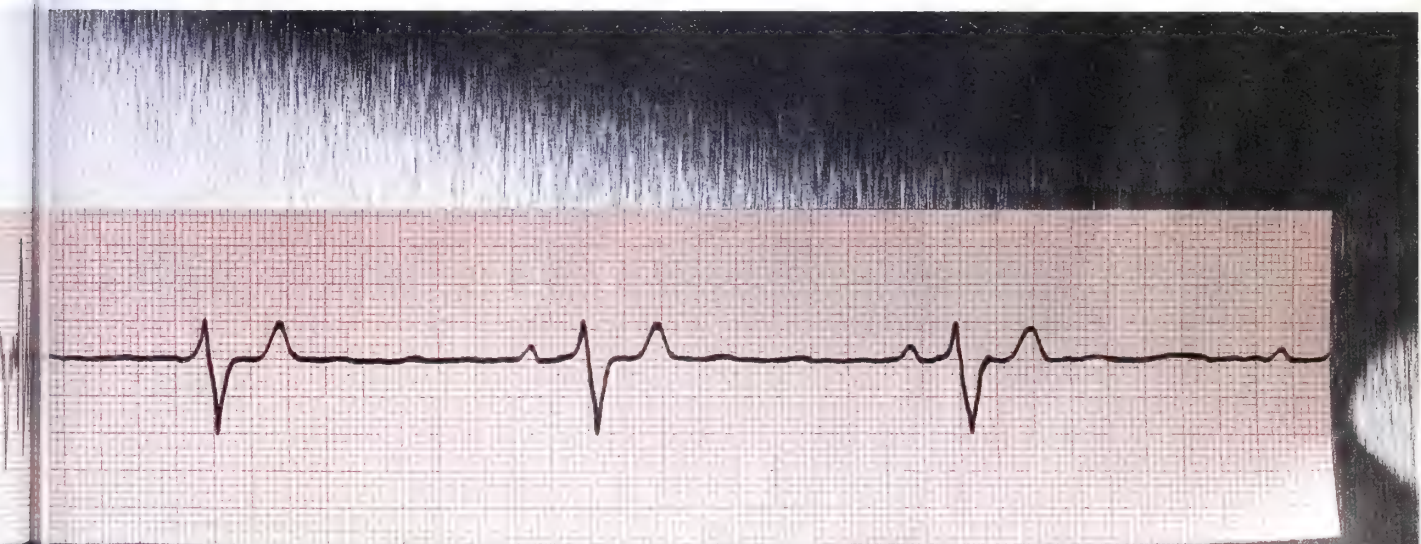


ing to write it off as a justly Darwinian outcome. "As a culture, we are deeply invested in the belief that the individual can determine his or her own destiny," Hilfiker observes. "So the poor who do not have the obvious disabilities we acknowledge must be somehow less worthy than the affluent."

One of the more fascinating strands of *Not all of Us Are Saints*, in fact, involves Hilfiker's own confrontation with the notion of individual responsibility. Are the travails of the impoverished all society's

sible relationship with a chronic alcoholic named Clint Wooden. After months of detox, relapse, and mutual bitterness, the two men wordlessly celebrate Wooden's sobriety. It's hard to do these four paragraphs justice except to note that they constitute one of the most moving, joyous passages I've ever read—the finest moment in a deeply passionate account of what it is to be a doctor, and what it is to be poor.

BY KEITH H. HAMMONDS
Hammonds reports on health care.



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HERE'S BALM FOR THE T&E BLUES

As an avid user of Quicken for Windows, the popular personal finance software program from Intuit, I have a pretty good fix on where my hard-earned loot disappears each month. By segregating my expenses into categories, I've discovered, to my chagrin, just how much I've squandered on eating out and compact disks. But keeping track of the cash I lay out on business trips is more challenging. Try as I may to stuff receipts in my wallet, I still seem to come up short at expense-report filing time. One solution would be to lug around a notebook computer with Quicken on it. Devoted as I am to the software, however, it's not practical to boot up a laptop just to record the fare each time I step out of a taxi.

Now, Intuit has unleashed a kind of Quicken Lite, aimed at folks on the run who carry around personal digital assistants. The scaled-down version, called Pocket Quicken, isn't yet sold as a separate product. Instead, it's built into the new 200LX palmtop computer from Hewlett-Packard, as well as the handheld Tandy/Casio Zoomer PDAs and the AST Gridpad 2390. The portable Quicken will also be on the Motorola Envoy personal wireless communicator, once that device turns up in stores, possibly this fall.

Like its grown-up sibling, Pocket Quicken lets users set up basic checking, credit card, and cash accounts to track expenses by category (food, gas, rent). To enter a transaction, HP users type in the payee, dollar amount, and other fields

that appear in the on-screen "check." As with regular Quicken, once you have begun typing a few characters, the program recognizes previously-entered names and fills in other data in the appropriate fields. Shortcut keys also automate the process. Users who press "T" when they're in one field, for example, can display the current date.

Pocket Quicken lets road warriors isolate what they spend by trip, client, project, or class. A salesperson who takes a customer for dinner



in San Francisco might categorize the amount spent as "dining" and "Bay Area." With an optional \$119 cable and software package for the HP 200LX and a \$30 add-on for Zoomer, people can share data with desktop Quicken.

But Pocket Quicken is not nearly as versatile as regular Quicken. Users can't track investments or set up budgets. Also missing: some of the reports that the complete product spits out (net worth, tax summaries) and all of its splendid graphs. Moreover,

anyone spoiled by full-size keyboards will find entering data into the HP 200LX, which runs an MS-DOS version of Pocket Quicken, to be a bit of a nuisance: Only Tom Thumb could touch-type on the thing.

With the Envoy, on the other hand, users tap the screen with a pen to make things happen. Pocket Quicken appears as a virtual billfold: Tap on the dollar bill that's sticking out of the wallet to activate a cash transaction; touch the Visa image to record credit-card transactions. You enter spending amounts by tapping an onscreen keyboard. While I found the Envoy more pleasing to use than the 200LX, the device won't fit into a pocket.

Businesspeople who eschew PDAs might want to stick with a copy of Quicken on their laptops—you can always

record expenses when you retire to the hotel each evening. A fine alternative, QuickXpense for Windows, is coming in October from Portable Software. The \$99 program lets users specify the type of expense account form they want. In fact, many expense forms from large corporations have already been loaded into the program. If your company's form isn't one of them, you can send a blank copy to Portable Software and the folks there will put it on a disk for you. As with Quicken, travelers make entries into a checkbook-style register. Among other features, QuickXpense can calculate mileage costs when you drive a car, convert foreign currency, and itemize each expense type—telephone, room service—found on your hotel bill. QuickXpense will even alert you when it's time to file an expense report. It's undoubtedly better to be hounded by the computer than by your boss. *E.B.*

BULLETIN BOARD

ATTITUDES

THE NOT-SO-POPULAR PC

Computer makers who dream of making their machines as ubiquitous as toasters have their work cut out for them. A survey by the public relations firm Porter/Novelli found that Americans still regard computers as harder to use than

LEARNING DIFFICULTY

(10=hardest, 1=easiest)

PERSONAL COMPUTER	5.
VIDEO GAMES	4.
VCR	3.
MICROWAVE OVEN	1.

DATA: PORTER/NOVELLI



any other high-tech home equipment. Respondents said that microwaves, television remote controls, and VCRs were the electronic products that had the most beneficial effect on their lives. Computers did rank ahead of cellular phones and CD players.

The survey also found that Americans spend an average of nearly nine hours a week in front of a computer screen and 9½ hours on the phone. However, they average almost 20½ hours watching TV.

DIRECTORIES

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Want to find an old business associate—or a college flame? Digital Directory Assistance of Bethesda, Md., has just introduced PhoneData for Windows, the company's first CD-ROM phone directory to exploit the Windows environment.

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HOW THE HOMELESS 'CRISIS' WAS HYPED

BY GARY S. BECKER



Yes, more people lacked shelter in the '80s. But the oft-quoted figure of 2 million to 3 million is pure fiction, as its author admits—and the hype has drawn attention away from more important problems

In 1982, Mary Ellen Hombs and Mitch Snyder, advocates for the homeless, estimated in their book *Homelessness in America: A Forced March to Nowhere* that between 2 million and 3 million people in the U.S. were then without a home. The magnitude of that figure helped create a perception that the number of homeless people was one of the major failures of U.S. social programs.

On the face of it, such an assertion—implying that more than 1 out of every 100 Americans in the 1980s had no place to live—simply wasn't credible. Indeed, a few years after publishing the estimate, Snyder conceded that it had no basis in fact. He admitted that he had simply pulled the number out of a hat to satisfy people pressing him for specificity.

Still, his fabricated estimate was accepted by many. Residents of large cities were receptive in the early 1980s to exaggeration about the number of homeless because their own anecdotal evidence was that a lot more people were sleeping on sidewalks and in public buildings and pushing their belongings around in supermarket carts during the day. But most Americans don't live in big cities, and homeless persons are much less common in the small cities and towns scattered throughout the U.S.

The implausibility of the Hombs and Snyder guesstimate did, however, stimulate efforts to obtain more precise numbers. One of the first, by Peter H. Rossi, then at the National Opinion Research Center in Chicago, counted the number of homeless in Chicago in the mid-1980s by sending interviewers out in the middle of the night. They found about 3,000 persons, less than one-eighth the number claimed by some local homeless advocacy groups. These groups in turn attacked Rossi for being uncaring and for slanting his estimates toward the low side. But his methods were much more scientific than those used by his critics.

URBAN PERCEPTION. Rossi's estimates and those of others are carefully reviewed in an excellent recent book, *The Homeless*, by the sociologist Christopher Jencks. He shows how difficult it is to define, let alone estimate, the number of people without homes. But he concludes that during any week in March, 1990—the date of the latest estimates—about 300,000 Americans were homeless in the sense that they slept either in free shelters or in public places not intended for habitation, such as bus stations, sidewalks, or abandoned buildings.

Jencks's review does indicate that homelessness greatly increased over time, which surely contributed to the perception among

denizens of New York, Chicago, and other large cities that it is so common. The number of people without a home seems to have more than doubled from the late 1970s to the mid-1980s, and probably increased in the 1990s and 1970s as well, but it does not seem to have grown much during the latter half of the 1980s.

Contrary to another myth propagated by television and homeless advocates, families with children make up less than one-fifth of the homeless population—the rest are mostly single males—and virtually all families are housed overnight in shelters. Even people who sleep on the streets or in public places generally can go to shelters—unpleasant as they may be—if they choose.

Jencks provides a good analysis of why homelessness increased over time and makes sensible suggestions for reducing its incidence and increasing the fraction who sleep in shelters. However, I am not concerned here with the causes and cures of homelessness but with advocacy groups' ability to convince a gullible public and media that homelessness had become a huge problem in America.

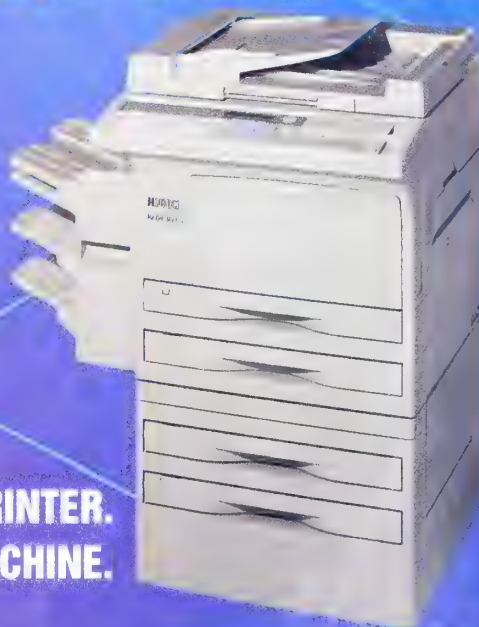
COMMON SENSE. In fact, the rather small size of the homeless population in reliable estimates indicates that, although the growth of homelessness is disturbing, it has been a much less serious social trend than several others that received little attention until the past few years. Those include the rapid escalation in the '60s and '70s, especially in cities, of robbery and other crimes against persons, the sharp fall during the past two decades in the earnings of high school dropouts, and the sharp lapse in the quality of inner-city schooling.

The public is constantly bombarded with exaggerated claims not only about the number of homeless but about many other subjects such as the number of people who will die of AIDS, the financial savings from radical changes in the health-care delivery system, the damage to health from various ingredients added to foods, and the size of the world population in the year 2050. It isn't easy to assess the reliability of confident assertions on complicated issues, but two common-sense checks often help in gaining perspective. An obvious one is to assess whether persons making the claim gain any advantage from exaggeration. A second, more difficult one is to look at the basis of the claims, since even a little digging often reveals the shallowness of their foundations.

If early assertions about the incidence of homelessness had been examined in this way, Snyder and others could not have so badly misled the American public.



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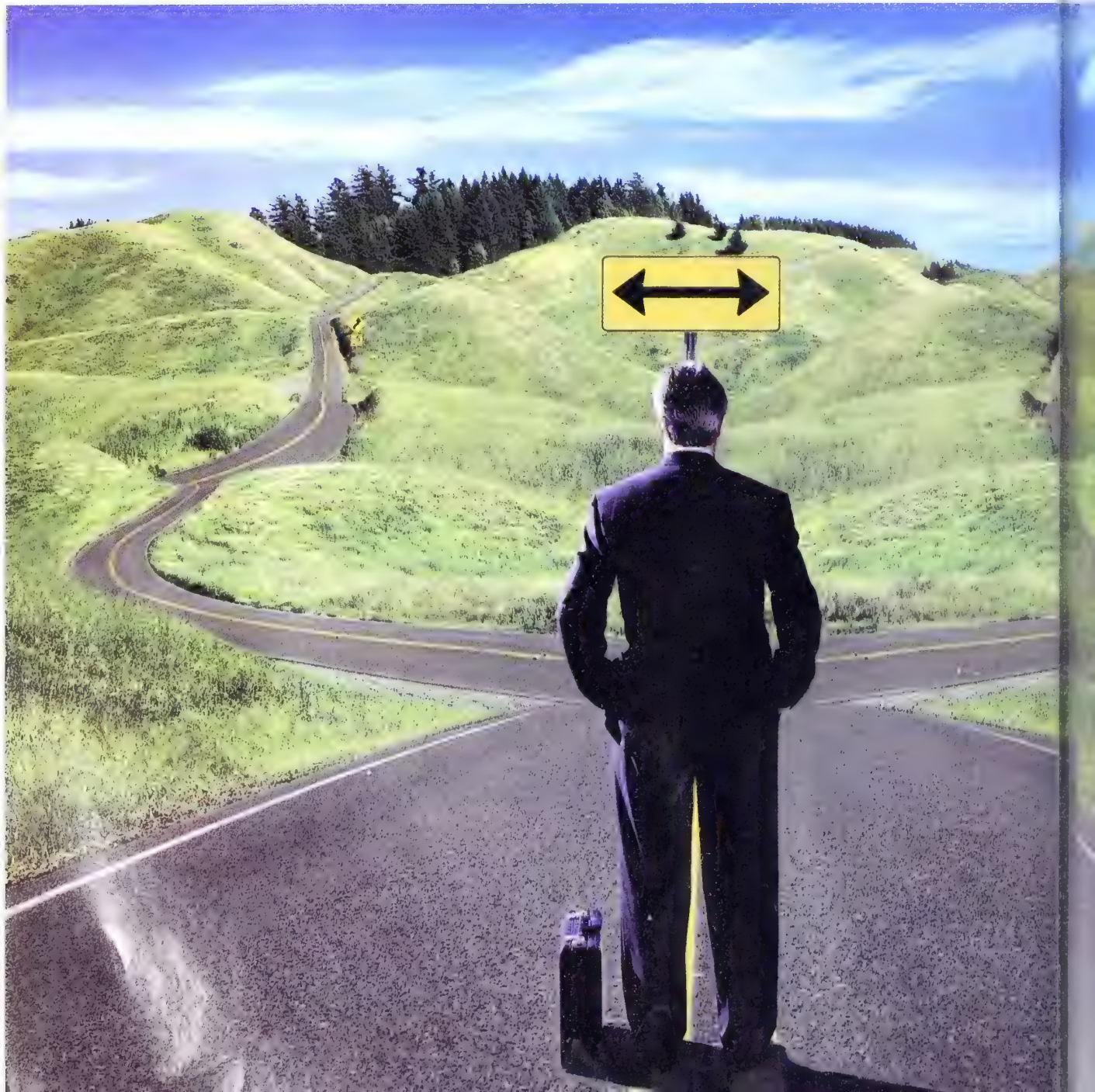
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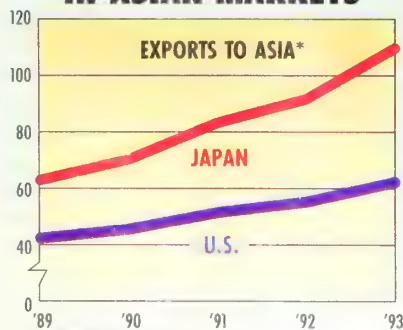
IN FAST-GROWING ASIA, JAPAN IS LEAVING THE U.S. IN THE DUST

While the U.S. cranks up pressure on Japan to open up its markets to American exports, U.S. companies appear to be missing the boat on an even bigger prize: the dynamism of Asia's far larger and more rapidly expanding emerging markets.

Already, notes economist C. Michael Aho of Prudential Securities Inc., the Asia/Pacific region accounts for 56% of the world's population. In 25 years, that's projected to grow to 62%—boosting Asia's population by as many as 2.5 billion additional consumers. Moreover, since 1986, many Asian economies have been expanding at a breakneck 6% to 7% annual rate, compared with 2% to 3% in Latin America.

More and more, says Aho, Japan is the dominant player among industrial nations active in the region. In recent

JAPAN'S GROWING EDGE IN ASIAN MARKETS



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*INCLUDES SOUTH KOREA, HONG KONG, SINGAPORE, INDONESIA, THE PHILIPPINES, MALAYSIA, THAILAND, TAIWAN, AND CHINA

DATA: INTERNATIONAL MONETARY FUND

years, Tokyo has given the area more than twice the foreign aid provided by Washington. And Japan's assistance has stressed infrastructure and industrial projects—an emphasis that builds ties between its industrialists and local elites.

More important, while Asia's share of U.S. direct investment in overseas regions is around 13%, its share of Japan's overseas investment since 1989 has jumped from 12% to 20%. And Japanese companies have concentrated on factories and distribution, whereas more than half of U.S. investment has been in petroleum, a depletable resource.

The upshot is that Japan's exports to Asia are exceeding America's exports

to the region by an ever-widening margin (chart). Indeed, Japan's trade surplus with Asia is now almost as large as its surplus with the U.S.

Given the geographical proximity, it's only natural, says Aho, that the U.S. should seek to expand trade and investment with Latin America. But China alone has more than three times the population of Brazil, Mexico, Colombia, Argentina, Venezuela, and Chile combined. And many Asian nations are already technologically advanced, with highly educated workforces and growing middle classes. "If American businesses don't wake up," warns Aho, "they will lose their chance to cash in on the world's greatest growth market."

SWEATERS, UMBRELLAS, AND SHOPPING SEEM TO GO HAND IN HAND

When the weather turns rainy and chilly, do you reach for your comforter—or your credit card? Unusual though it may seem, extremely wet and cool weather spurs consumers to spend. That, at least, is the finding of Michael P. Niemira, chief economist at Mitsubishi Bank Ltd., which will be publishing his monthly *Weather-Economic Barometer*.

Niemira looked at data from the Commerce Dept.'s National Climatic Data Center and formulated the WEB, which measures the percentage of the 48 contiguous states in the U.S. experiencing abnormally cool and wet weather. The higher the index, the more the states that are suffering snow, rain, and chill.

Not only does Niemira find a correlation between shifts in the weather and shifts in consumer spending but he goes on to calculate that the trend explains 25% of the changes in consumer spending. And a shift in the WEB prefigures changes in outlays for as long as eight months. Niemira isn't exactly sure why rain or frost cause people to spend, but he speculates that keeping warm is a factor. "If it's cooler, the weather triggers more energy use," he notes. "And it is more conducive to shopping for heavier clothing."

So then what is the Mitsubishi Bank's WEB saying about consumers' shopping habits during the next eight months? Niemira says the drop in the index since the beginning of 1994 suggests that spending will slow into 1995. And "that comes at a critical time for the economy," he adds, since inventory overhangs and higher interest rates are already reining in growth. In other words, retailers cannot just worry about tax hikes,

slower job growth, or higher interest rates as drags to consumer spending. Now, they have to fear global warming as well.

By Kathleen Madigan

NEVER MIND THE INDEXES—A LOT OF STOCKS GOT POUNDED

Don't be overly impressed by the resiliency of the blue-chip stock averages in the past few months, cautions economist Douglas Ramsey of SCI Capital Management Inc. in Cedar Rapids, Iowa. "The average stock," he says, "has undergone a brutal correction this year."

From their July, 1993, to February 1994, peaks through July 31 of this year, the best-known stock indexes have registered declines from about 5% to 10%. But these numbers are deceptive, notes Ramsey. He calculates half the stock on the American Stock Exchange are in the NASDAQ market posted declines of at least 22% and 27%, respectively. Indeed, a quarter of all NASDAQ-traded stocks were down 50% or more.

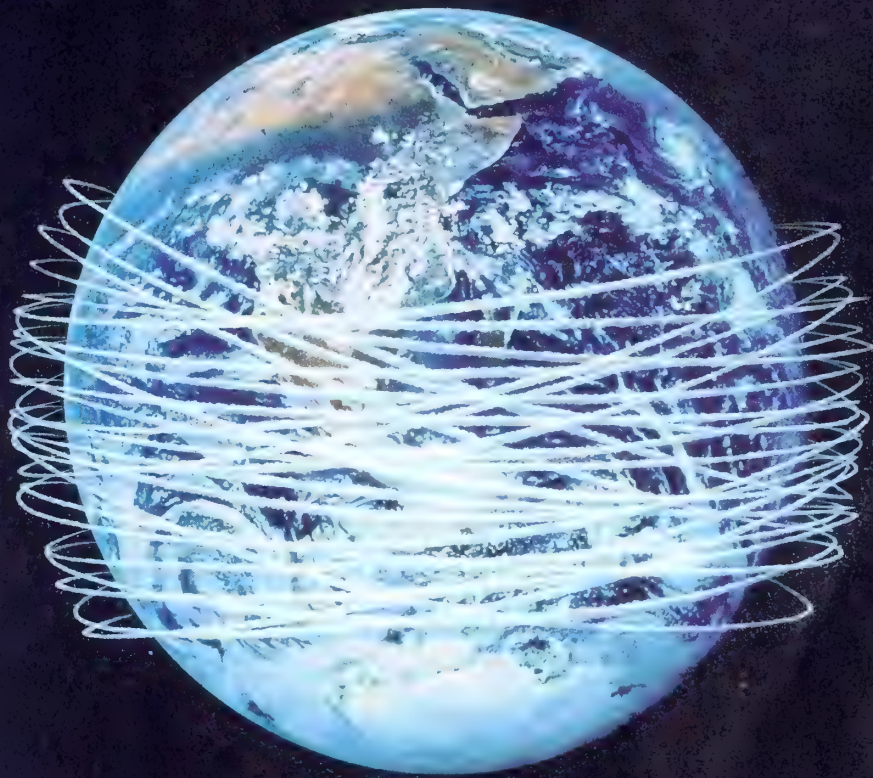
In periods of rising interest rates and tighter liquidity, explains Ramsey, "investors retreat to the highly liquid large-cap stocks." Right now, he thinks the market may be regaining some breadth in hope that slowing economic growth preclude more rate hikes. "But if the Fed tightens further, the stocks of many smaller companies could be clobbered again."

PUBLIC-WORKS OUTLAYS DON'T DO MUCH TO GOOSE PRODUCTIVITY

In recent years, economists have paid increasing attention to the economic impact of infrastructure spending—good old-fashioned public works. Some economists argue that the drop-off in public spending on roads, bridges, and the like over the past two decades had a large negative impact on U.S. productivity growth in the 1970s and 1980s. But in a recent National Bureau of Economic Research paper, economists Douglas Holt Eakin of Syracuse University and Ann Ellen Schwartz of New York University cast doubt on the relationship. They developed a growth model to analyze the impact of public capital accumulation on productivity and then studied the experience of the 48 contiguous states between 1971 and 1986. Their conclusion: that public-works outlays aren't significant in explaining the growth rates of states.

By Christopher Farrer

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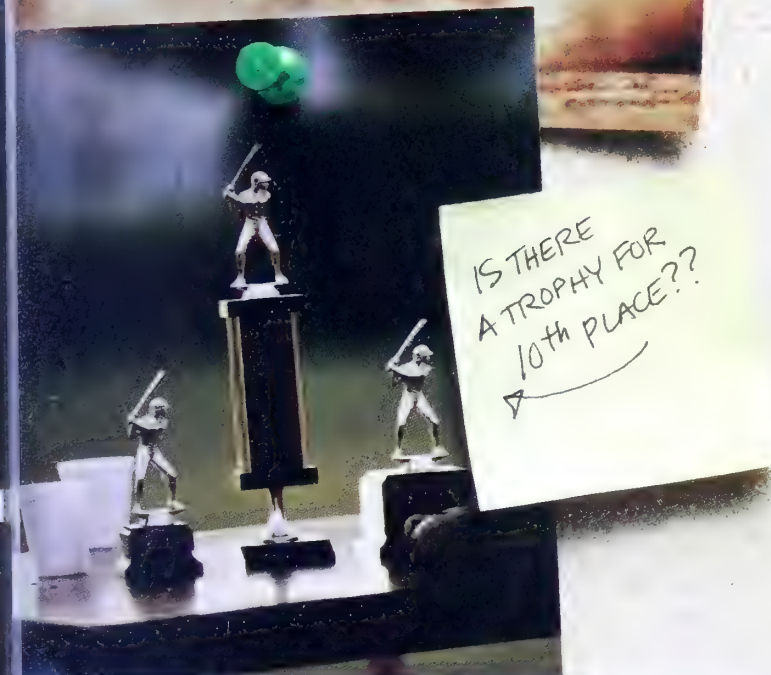
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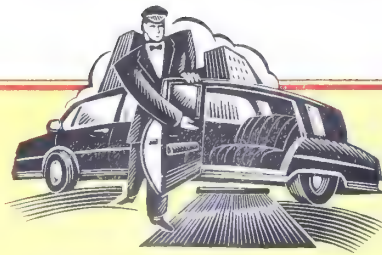
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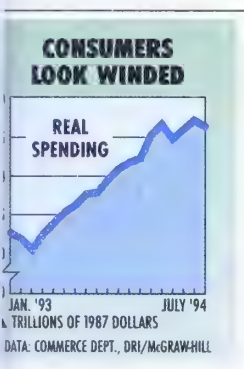


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GROWTH IS DOWN, BUT NOT OUT

The key question about the U.S. economy right now is not "Is the economy slowing down?" It's "How much?" The way the third quarter is shaping up, growth may struggle to reach 2%, and it might end up being less than that.

Of course, the economy's fundamentals, such as consumer incomes and corporate profits, remain solid, suggesting that any growth swoon this quarter is not a prelude to a lasting malaise. But the third quarter, at least, is off to a poor start. July readings for real consumer spending and factory orders both fell, and the leading indicators were flat. August retail sales look uninspiring, and consumer confidence dipped.



The numbers say that overall demand in the third quarter has no bounce following its weak second-quarter showing. The Commerce Dept.'s revisions to last quarter's gross domestic product put growth in real final sales of all goods and services at a paltry annual rate of only 1.4%, a bit lower than the 1.5% pace first reported.

Commerce left its original reading for second-quarter real GDP largely unchanged. It revised growth to a 3.8% annual rate from 3.7%, despite the more substantial upshift generally expected. However, the latest data also left the huge inventory buildup intact—actually increasing the accumulation slightly, to a \$56.3 billion rate, the largest quarterly growth in 6½ years.

However, inventories cannot rise at that rate for very long. If stockpiles grow at a slower but more sustainable \$30 billion pace this quarter, that would subtract about two percentage points from GDP growth. If so, the remainder of GDP, final sales, would have to rise 4% for the third quarter to manage a mere 2% advance.

RATE HIKES ARE BITING INTO DEMAND

The trouble is, demand is not growing anywhere near that fast. That's especially true in the consumer sector, which is two-thirds of final sales (chart). Real consumer spending in July fell 0.2% from June, putting quarterly growth so far at only a 0.5% annual rate. Just to reach modest 2.5% pace for the quarter, monthly real outlays would have to rise a hefty 0.5% in both August and September.

That seems highly unlikely. August surveys of retailers

show encouraging gains from a year ago, but not much strength compared with July. In particular, the *Johnson Redbook Report's* sampling of department and chain stores showed August sales up 8.7% from last year but down 1.1% from the previous month.

Higher interest rates have had their biggest impact on sales of homes, cars, and other durable goods. Real consumer purchases of durables fell 1.1% in July, mainly reflecting lower car sales. Sales of cars and light trucks have fallen for four consecutive months, suggesting that the weakness reflects more than just supply shortages of popular models.

BUILDERS' HOPES FOR SALES ARE WANING

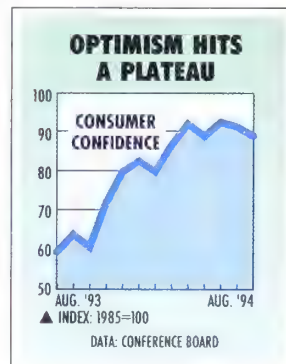
Rising rates have clearly hit home buying. Although sales of new single-family homes rose 8.3% in July to an annual rate of 664,000, they had dropped 11.4% in June. July sales are about even with the second-quarter pace, which had fallen from the first-quarter level, and that was down from 1993's fourth-quarter peak. Existing-home sales slid 0.3% in July.

Although higher mortgage rates have cut some buyers out of the market, others are getting around higher borrowing costs by bargaining harder or settling for less. The increases in prices for both new and existing homes have slowed markedly. In July, in fact, the median price of a new home was below the selling price a year earlier.

Little wonder that builders' optimism is waning. The number of builders who expect "good" home sales in August held at the July rate of 32% after dropping steadily during the past several months from a high of 72% in November, 1993, says the National Association of Homebuilders.

Consumers' spirits are also flagging a bit under the uncertainty over the impact of the Federal Reserve's rate hikes, along with continued worries about job security. The Conference Board's index of consumer confidence dipped 2.3 points, to 89, in August, the second consecutive decline (chart). Households gave less optimistic assessments of both their present situations and their expectations six months down the road.

The combination of a slower pace of consumer spending and the big inventory buildup at retailers and wholesalers



Business Outlook

appears to be falling back on the manufacturing sector. Factory orders for both durable and nondurable goods fell 2.3% in July, the largest drop in 2½ years (chart). Even excluding the month's unusually large order declines in autos and aircraft, bookings were still weak.



Moreover, factory inventories jumped 0.9% in July, the largest increase in 3½ years, with finished goods accounting for most of the increase. That's the first hint that production is running ahead of demand, portending a slowdown in factory production this fall.

Weaker ordering was one reason for the flat reading in the composite index of 11 leading indicators in July. The index, designed to project the economy's pace in the coming months, has gone nowhere since March—another sign that the economy is due for slower growth.

WHY THE EXPANSION IS NOT IN TROUBLE

Of course, all this doesn't mean that the expansion is headed down the tubes. Two favorable trends are supporting both consumers and businesses: Solid job growth is buoying household incomes, and rising profit margins are boosting corporate earnings. These patterns will sustain a moderate if slower pace of economic growth heading into 1995.

In particular, corporate profits continue to exceed expectations. By Commerce's accounting, before-tax operating earnings, which adjust for changing inventory values and for the difference between tax- and replacement-cost accounting, jumped 7.7% in the second quarter, to an annual rate of \$547.3 billion, a gain of 15.7% from a year ago.

Moreover, because of efforts to control costs and enhance productivity, profit margins continue to rise. Oper-

ating profits of nonfinancial companies as a percentage of real output rose to 12.8% last quarter, a record high (chart).

The strength in profits partly explains the stock market's summer rally. But more important, signs that the economy is slowing to a moderate, noninflationary pace mean that the Federal Reserve will not be hiking interest rates again any time soon. That removes a big cloud of uncertainty that had been hanging over investors.

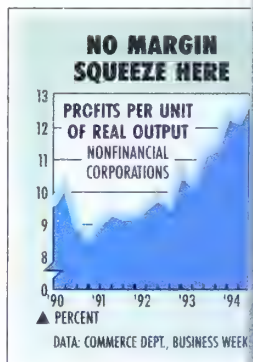
The bottom line for consumers isn't skimpy, either. Personal income climbed a healthy 0.5% in July as wages and salaries scored another solid gain. After taking off taxes and inflation, real disposable earnings rose 0.2%.

The problem is that consumer spending has been growing faster than income. In the second quarter, real income grew a respectable 2.8% from a year ago, but real outlays rose 3.5%. The same thing happened in the previous year: income up 2.2%, spending up 3.4%.

That imbalance is a big reason why consumers are beginning to slow their spending and add to their savings. Of course, the underlying pace of incomes remains supportive of modest growth, which is why the economy is hardly in any danger of recession.

In fact, once the inventory overhang is pared down, demand will be the prime force in determining output. And because companies and consumers can depend on healthy earnings, economic growth could very well bounce back to 3% or so in the fourth quarter.

So when Commerce reports on third-quarter GDP in late October, don't panic. In fact, be happy knowing that the Fed, which meets shortly after the number comes out, is likely to have little justification for putting through another hike in interest rates.



THE WEEK AHEAD

VEHICLE SALES

Tuesday, Sept. 6

Sales of domestically made cars and light trucks likely rose to an annual rate of 11.9 million in August, after falling 5.7% in July, to an annual rate of 11.6 million. That's the median forecast of economists surveyed by MMS International, a division of McGraw-Hill Inc. The July drop reflected low inventories of popular models as well as the slowdown in consumer spending.

UNEMPLOYMENT CLAIMS

Thursday, Sept. 8, 8:30 a.m.

New claims for state unemployment benefits probably bounced back up during

the week ended Sept. 3 from the 322,000 filed during the week ended Aug. 20. Claims have been trending lower since July, but seasonal work is now ending for many employees.

CAPITAL SPENDING PLANS

Thursday, Sept. 8, 8:30 a.m.

The Commerce Dept.'s summer survey of capital budgets will probably show that businesses still intend to increase their spending on new plants and equipment by about 8.3% for 1994. Most of the increase, however, likely took place in the first half of this year, with outlays projected to rise only slightly in the last two quarters. Capital spending advanced 7.1% in 1993.

INSTALLMENT CREDIT

Thursday, Sept. 8

The MMS median forecast is that consumers added an additional \$9 billion to their debt loads in July. Credit card purchases mushroomed by more than \$10 billion in each of the preceding four months.

PRODUCER PRICE INDEX

Friday, Sept. 9, 8:30 a.m.

Producer prices of finished goods probably rose 0.4% in August on top of a large 0.6% rise in July, say the MMS economists. Higher energy prices caused both increases. Excluding food and fuel, producer prices likely rose 0.3% in August after a mere 0.1% gain in July.



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MERGERS TODAY, TROUBLE TOMORROW?

IT MAY LOOK LIKE THE '80s, BUT FOR LOTS OF REASONS, IT'S A WHOLE NEW DEAL

Telecommunications. Defense. Railroads. Pharmaceuticals. Retailing. Health care. Banking. Entertainment...

The list seems endless. A stampede of deals, unmatched in number and scale since the heyday of junk-bond-financed takeovers in the late 1980s, is sweeping through Corporate America. On Aug. 29, drugmaker SmithKline Beecham PLC announced it would plunk down \$2.93 billion for Eastman Kodak Co.'s over-the-counter products unit. The very next day came a real blockbuster: Lockheed Corp. agreed to combine with Martin Marietta Corp., forming a defense giant with sales of \$23 billion.

Add those two to the heap, and corporate dealmeisters have engineered close to \$210 billion worth of mergers and acquisitions so far this year, according to Securities Data Co. Driven by massive technological change, international competition, deregulation

and—above all—the incessant demand to cut costs, announced transactions by yearend should approach the 1988 record of \$336 billion. Even greater consolidation is likely in the years ahead. Proclaims Harvard business school professor Michael C. Jensen: "We're going through a third industrial revolution," marked by efforts to eliminate excess capacity.

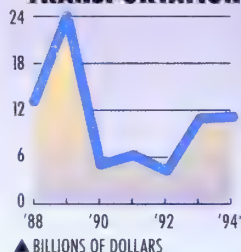
The M&A whirlwind calls to mind past eras of consolidation: the merger-rampant 1920s, the conglomerate-building 1960s and 1970s, the leveraged-buyout-crazed 1980s. And it raises many of the same questions. Will combinations within industries reduce competition and drive up prices? Could mergers undermine innovation? Should the federal government be taking more aggressive action?

WHERE THE ACTION IS

Annual value of announced mergers and acquisitions

1994'S BIG DEALS:

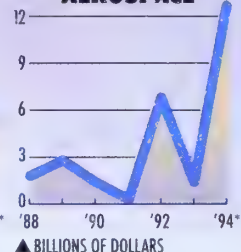
TRANSPORTATION



▲ BILLIONS OF DOLLARS

Burlington Northern spends \$2.7 billion for Santa Fe Pacific

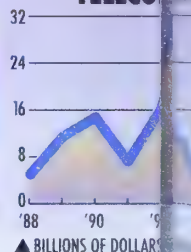
AEROSPACE



▲ BILLIONS OF DOLLARS

Lockheed and Martin Marietta's \$10 billion merger

TELECOM



▲ BILLIONS OF DOLLARS

LDDS Communications acquires WorldCom \$2.5 billion



ust measures? And, most vexing of all, do these deals really work?

This dealmaking era is undoubtedly different than previous ones. Increased size, for instance, no longer ensures a company the ability to monopolize. Indeed, global competition has dramatically reduced the ability of companies to control pricing in any national market. And low barriers to entry—such as cheap capital and excess capacity—along with rapid technological change, render any dominant market position fragile.

Take the tire industry. Despite huge consolidation during the late 1980s, the three largest companies, which control more than half of the market, have largely been unable to enforce price controls. In that industry and others, says outgoing Continental Bank Corp. Chairman Thomas C. Theobald, “the opportunity to monopoly-price is pretty damn limited.”

Instead, companies are more likely to combine these days to gain a place in a highly competitive national or interna-

tional markets. BankAmerica Corp.'s \$1.9 billion acquisition of Continental, set to close on Aug. 31, already has given it access to Midwestern customers. Reliance Electric Co. cited its need for muscle to conquer foreign markets as one motivation for its \$1.39 billion merger with General Signal Corp., announced Aug. 30. Says Reliance Treasurer John D. Hutson: “It should be easier for a \$3.5 billion company to move overseas than a \$1.5 billion company.”

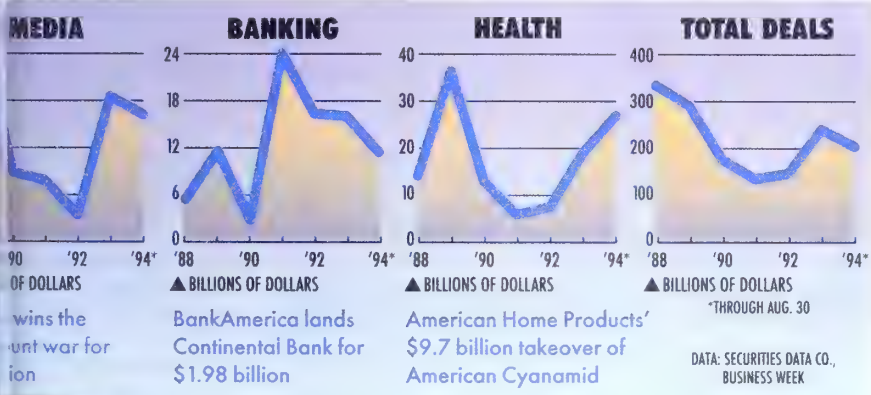
The new competitive environment may explain the Clinton Administration's low antitrust profile. In health care and defense, the Administration is encouraging consolidation to wring out costs. Still, “we'll do something if we see a merger that will adversely affect market share and that may hurt consumers down the road,” declares Steven C. Sunshine, the Justice Dept.'s deputy assistant attorney general for antitrust.

Indeed, federal antitrust agencies insist they are becoming more aggressive.

Last year, the Justice Dept. intervened in 20 mergers, up from an average of 8 to 10 in the Bush years. One concern: vertical integration. That's what's driving the Federal Trade Commission's examination of pharmaceutical giant Eli Lilly & Co.'s pending \$4 billion combination with drug distributor PCS Health Systems Inc. But the feds didn't act in similar purchases by rivals Merck & Co. and SmithKline. Now, regulators have become anxious that drugmakers could exercise undue control over the market for their product by controlling major distributors.

HARDER THEY FALL? Regulators concern themselves less with a deal's actual effectiveness. Historically, though, it has proved exceedingly difficult to pump up profits by merging. University of Chicago finance professor Steven N. Kaplan says 49% of acquisitions made between 1971 and 1982 were divested, many because they failed to work. USAir Group Inc., for instance, snatched up regional rivals during the 1980s, expecting to gain some measure of pricing control and to boost profits from increased volumes. Instead, the difficulty of combining operations and the advent of nimbler rivals has forced the carrier to restructure.

Heightened shareholder involvement, plus new technology that will help companies wring new efficiencies, may make this round of dealmaking different. Take hospital giant Columbia/HCA Healthcare Corp. The 196-hospital chain, the product of two mergers in the past year, already is enjoying the benefits of consolidation. Chief Operating Officer David



Will innovation suffer? The feds will be watching

Top of the News

T. Vandewater notes that efforts to slash supply costs—a result of added purchasing power—helped boost operating margins during the first half of 1994 to 20.2% from 19.5% in last year's second quarter.

Food wholesalers report similar benefits. In June, the nation's second-largest grocery wholesaler, Fleming Cos., agreed to buy the third-largest, Scriv-

er Inc., for \$1 billion. Fleming Executive Vice-President Gerald G. Austin expects to cut \$90 million from the companies' combined selling and administrative costs by 1997—savings that will fall to Fleming's bottom line. The transaction should also boost Fleming's borrowing power so it can invest in technology and new facilities.

Will the new Lockheed Martin Corp.

reap similar gains? It will be years before we know for sure what that merger and others will yield. What we know is that there will certainly be others. In airlines. Publishing. Food. Consulting. Computers. . . .

By Kevin Kelly and Richard A. Melzer in Chicago, with Zachary Schiller in Cleveland, Catherine Yang in Washington and bureau reports

DEALS

'THIS IS GOING TO BE THE BIGGEST KAHUNA AROUND'

Rivals are reeling in the wake of the Martin Marietta/Lockheed merger



After sealing the megadeal to merge his company with Martin Marietta Corp., Chairman Daniel M. Tellep of Lockheed Corp. retreated to a quiet dinner with his wife at New York's Pierre Hotel. Martin Chairman Norman R. Augustine didn't even stick around when his lawyers popped champagne corks.

The two corporate chieftains may seem blasé about their stunning Aug. 29 proposal to wed the nation's No. 2 and 3 arms makers, but the rest of the defense industry reacted as if one of Martin's Titan IV rockets had just blasted into their boardrooms. "It scares the be-jeezus out of us," says one defense company executive. "This is going to be the biggest kahuna around."

BLAST OFF. Indeed, with combined annual sales of \$23 billion, the new defense behemoth will be 50% larger than its nearest competitor, McDonnell Douglas Corp. The threat of Lockheed Martin's muscle, industry executives say, likely will spur marriages among arms makers fighting for military orders that have shrunk steadily since 1987.

The Pentagon, with the tacit approval of the Justice Dept., has encouraged such consolidation—because it would rather rely on a few efficient producers than numerous weak ones. But now the activity is arousing antitrust fears among smaller companies and members of Congress, who may try to bust up the mergers on anticompetitive grounds. That's one more reason contractors may rush

to complete deals. "Companies will be more eager to sell over the next year, before the well is poisoned and ahead of further cuts in defense spending after 1995," says Chuck Gabriel, a senior defense analyst with Washington Research Group.

At first glance, Wall Street agreed with Gabriel's assessment, bidding up defense stocks in the wake of the announcement. Speculation swirled around Loral Corp., a defense-electronics conglomerate that has been acquiring companies at a heady pace, and on McDon-

Such a deal could be worth \$2.5 billion.

Beyond giant courtships, analysts expect a surge in linkups among arm components makers and second-tier suppliers. "You will see a trickle-down effect," forecasts Richard Pettibone, analyst at Forecast International.

Partnerships, for example, are likely among the handful of U.S. helicopter makers: Textron's Bell Helicopter division, United Technologies' Sikorsky unit, Boeing, McDonnell, and Hughes—too many chopper makers battling for dwindling Pentagon purchases. Likewise, cuts in military orders for ships and submarines will force shipbuilders to consolidate. A potential victim: Maine's Bath Iron Works, which builds a shrinking number of Navy destroyers.

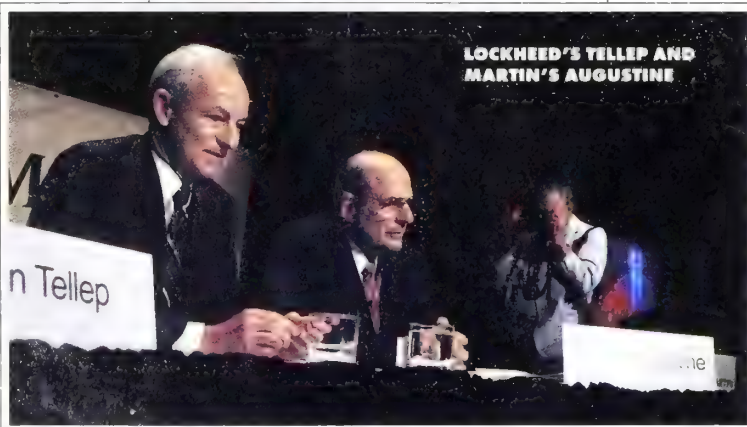
A MONSTER. Defense experts predict that a similar merger wave will wash over Europe, as players there scramble to match Lockheed Martin's breadth and pricing power. Talks between Britain's

General Electric Co. and British Aerospace Plc., which had met government resistance on armament concerns, may heat up again. If European arms makers don't follow suit, they could lose out to the U.S. on Asian and Middle Eastern orders, which have become critical to keeping Western production lines going in the post-cold-war era. As ready, says Forecast's Pettibone, "you could almost go to Lockheed Mar-

and outfit your whole country."

The new defense monster still has a lot on its plate. Martin has barely digested its 1992 acquisition of General Electric Co.'s aerospace division and has just started on its December, 1993, purchase of General Dynamics Corp.'s space systems unit. But the gloomy outlook for arms spending ensures that even Lockheed Martin won't wait long before its next deal. In the weapons business now, it's eat or be eaten.

By Amy Borrus in Washington, with Suzanne Woolley in New York and Tom Smart in New Haven, Conn.



nell Douglas, maker of F-15 fighters, which has shunned much of the merger mania. "The pressure is on McDonnell to start finding new businesses," says Richard A. Bitzinger, an analyst with Defense Budget Project, a think tank.

And no one is counting out further purchases by Lockheed Martin. The new colossus will generate \$4 billion to \$5 billion in cash over five years, giving it the resources to add to its arsenal. The latest buzz: Lockheed Martin is already eyeing a merger with Northrop-Grumman, which launched the industry's "merger of equals" trend last spring.

WELCH MAY BE SEEING GREEN

Is pondering a takeover of American Express



Is American Express Co. about to become part of the takeover fray? A senior AmEx employee told BUSINESS WEEK that General Electric Capital Services Co., GE's financial-services arm, has approached AmEx about buying the charge-card company. And an investment banker also says that GE has made an overture to AmEx. Neither company would comment. A deal between the two would be one of the biggest ever. AmEx, now trading at \$28, has a market value of \$14 billion. It is likely to fetch \$40 per share, says Mark Boyar, who runs a New York money management firm that researches takeover candidates—putting its total price tag at \$20 billion. Analysts figure that GE, with a market value of \$89.6 billion, is sitting on \$5 billion in cash,



though Boyar thinks it would opt for a stock swap. "I've always said [GE chief Jack] Welch wants to do one more major takeover," says Boyar. "The ultimate would be American Express." **SECOND COURTING.** To many on Wall Street, such a combination makes sense. GE's aborted bid for Kemper Corp. earlier this year signaled its interest in entering the mutual-fund business. And AmEx owns IDS Financial Services Inc.,

which manages \$103 billion in funds. GE, moreover, has lots of experience in the card business: One of its divisions processes credit cards for the likes of R. H. Macy & Co. and Exxon Corp. The timing also may be right. GE and AmEx discussed a merger four years ago, say former AmEx insiders, but GE was turned off by AmEx's Shearson Lehman Brothers Inc. and its enormous liabilities. AmEx, however, sold Shearson last year and spun off its Lehman Brothers unit earlier this year. AmEx could use a strong partner. In search of a turnaround in its ailing card business, it is having to take extreme measures. As part of a major cost-cutting effort, employees expect it to cut staff by 10% this fall. This fall, too, AmEx will announce a big plunge into the revolving credit-card business, a spokesman confirms—a major departure for a company known for its charge card. It plans to launch a dozen credit cards aimed at niche markets tailored to different customers' needs. Still, GE might not win AmEx without a fight. Analysts cite other possible bidders, from General Motors to Citicorp. With AmEx stock a longtime laggard, a serious bidder would be hard to resist. *By Leah Nathans Spiro in New York, with Tim Smart in Connecticut*

WINGDING ON WALL STREET

Analysts expect a surprise summer rally to level off



Explosive stock market rallies have a way of creeping up on investors. And for most of this summer, Wall Street didn't expect much upside action. Nonetheless, from Aug. 23 to Aug. 31, the Dow Jones industrial average racked up 162 points, or 4.3%, to rise above 3913, its highest point in more than six months and only 1.7% below the 3978 record set on Jan. 31. Some market-timers ask: Could this be a repeat of August, 1982, when an out-of-the-blue surge kicked off the 1980s bull market? There are a number of reasons for optimism. Dealmania, one. Through August, companies have announced more than \$200 billion worth of merger-and-acquisition activity—about half of it since the be-

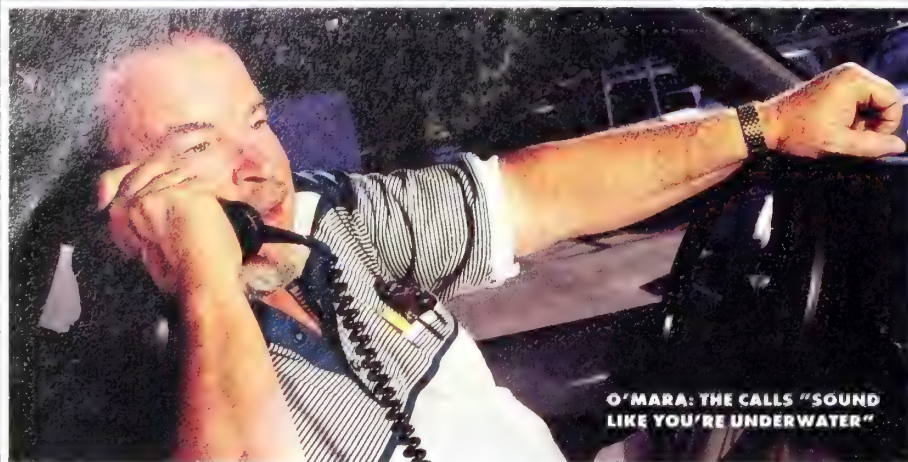
ginning of July alone, says Securities Data Co. The frenzied activity is giving stocks a nice boost: On Aug. 30, for example, aerospace and defense stocks soared on the news of the Lockheed-Martin Marietta deal. Small investors also get credit for the market's upswing: Net cash flow into equity mutual funds in July was \$9.2 billion, a 20% increase from June. August inflows should climb about 15%, says Robert Adler of AMG Data Services. **BEAR TRAP.** The market's rally didn't really take hold until the street had digested news of the Federal Reserve's Aug. 16 hike in short-term interest rates—its fifth in six months. "When the market didn't swoon, buyers rushed in with cash that had been building up all summer," figures

investment manager Christopher P. Baker of C. P. Baker & Co. How strong is the rally? Most likely, it's neither the start of something big nor a "bear trap"—a temporary revival that lures investors into believing it's the beginning of a bull market. The market's trading range may ratchet up, but rising interest rates mean even optimists don't foresee a new beachhead beyond Dow 4000. Investment strategist Charles I. Clough of Merrill Lynch & Co. notes that the yield on 10-year Treasury bonds is 2.5 times that of the yield on the Standard & Poor's 500-stock index. Four of the last five times that happened, the stock market advance ground to a halt. Yet despite healthy corporate profits, dividends are up just 1.5% this year.

Still, some investors are looking beyond the rate squeeze. Strategist Jeffrey M. Applegate of CS First Boston expects the Fed to have done most of its tightening by early 1995. So he remains a bull, reasoning that tight monetary policy will contain inflation, prolonging the economic expansion—and the bull market. The bottom line: This market may not soar, but it isn't about to tank either. *By Jeffrey M. Laderman in New York*



(TOP TO BOTTOM) PHOTOGRAPH BY ALAN BASEDEN. PHOTOGRAPH BY STEPHEN FERRY. CHART BY USA KNOWS BRAIN/BN



O'MARA: THE CALLS "SOUND LIKE YOU'RE UNDERWATER"

HOW MCI GOT A BAD CONNECTION

It overlooked Nextel's technical flaws—and may just hang up on the deal



In January, when Nextel Communications launched a souped-up digital dispatch service in Los Angeles, Thomas O'Mara was one of the first customers to sign up. The owner of O'Mara Plumbing Co. was lured by the promise of superior sound quality and an expanded calling area for his 10-truck fleet. Nextel even threw in steeply discounted mobile-phone service.

Eight months later, O'Mara has a verdict on this latest entry in the wireless sweepstakes: The dispatch service is terrific. The phones? Well, O'Mara got what he paid for. Calls, he gripes, "sound like you're underwater."

If you want to know why MCI Communications Corp. on Aug. 29 pulled out of a deal to pay \$1.36 billion for 17% of Nextel, look no further. In February, it thought it had found a clever, state-of-the-art way to compete with cellular-phone companies: Nextel planned to use existing dispatch licenses to build a national digital-phone service rivaling cellular's quality. Instead, MCI bought a lot of static. "The quality just wasn't there," says Barry Goodstadt of EDS Management Consulting Services.

WORMY BITE. The deal underscores the risks that accompany the telecommunications industry's headlong plunge into the future. Under intense competitive pressures, say company insiders and former executives, MCI officials failed to do their homework on the new technology. "Sometimes when you bite the apple

first, all you get is worms," notes P. William Bane of Mercer Management Consulting Inc.

It's easy to see why Nextel caught MCI's fancy. Archrival AT&T had agreed the summer before to merge with McCaw Cellular Communications Inc. Buying a cellular operation would be hugely expensive. And the other option for entering the wireless business—the Federal Communications Commission's auction of 2,000 separate licenses for personal communications services (PCS)—would have made assembling a national network difficult.

So when Nextel's chairman, super-salesman Morgan E. O'Brien, knocked on MCI's door, Chairman Bert C. Roberts Jr. was receptive. Nextel would give MCI an entrée to wireless markets across the nation before PCS could take root. And MCI would provide Nextel with deep pockets to fund expansion and with a brand name to help market its service.

But MCI's top brass made a critical misstep: They didn't clue in technology-savvy subordinates. Those aides winced when they saw the deal. Nextel's system operated with only 10 megahertz of radio-spectrum capacity, far less than the 25 Mhz that cellular companies use. To improve quality, Nextel would have to reduce the number of calls it handled or build a vast network of radio towers. Either option would boost the average cost per call far higher than MCI had initially figured, dramatically altering the value of its deal.

REDIALING

MCI With AT&T-McCaw breathing down its neck, MCI still needs a foothold in wireless. It may bid for radio spectrum at the FCC's December auction or link up with a Baby Bell.

NEXTEL If the deal doesn't go forward, Nextel will need cash to expand its network. And the company also could use another big-name partner to help sell its service and to establish brand-name recognition.

MCI did not carry out engineering studies confirming these fears until after the deal was announced, say executives involved in the negotiations. MCI won't comment. Nextel confirms it had quality problems. But "customer satisfaction has improved dramatically," says James L. Dixon, president of Nextel's Digital Mobile Networks Div.

DISENCHANTMENT. Meanwhile, the FCC was making PCS more attractive. In June, the commission overhauled its action plans to make it far easier to cobble together the national network that MCI covets. The FCC's moves and a disenchantment with Nextel fueled opposition inside MCI to the linkup, which was supposed to be completed by June 30. One senior wireless executive, Albert Grimes, left in July, disgusted with the deal. As the talks dragged on past the deadline, MCI insisted on improving quality by lowering capacity—and demanded a price break.

Nextel resisted. It needs cash to defend its network, established primarily with equity-based acquisitions. Motorola, which holds a major stake in Nextel, can veto any future Nextel deals, and balked. In early August, Motorola sold its remaining dispatch licenses to Nextel for \$1.7 billion in stock. Motorola feared that if MCI dropped its price, the proceeds of its licenses sale would plummet. In fact, Nextel's stock dropped 1% to 25% on MCI's pullout.

The talks go on. But now, MCI has other options. If it wants to line up partners for the FCC auction and use its \$3 billion for the bidding, it must decide by October, when applications are due to the commission. Such a strategy remains problematic. But in the end, a direct route to market may be safer than a back-door approach: In devising the Nextel deal, MCI may have been too clever for its own good.

By Mark Lewyn in Washington

SMITHKLINE'S NEW WORLD ORDER

Sterling gives the drugmaker a fast-growing franchise in Europe and Asia



SmithKline Beecham PLC Chief Executive Jan Leschly is a former tennis player with a good sense for when to change the net. On Aug. 29, he made his move, announcing SmithKline's second multibillion-dollar acquisition in four months—the \$2.9 billion purchase of Eastman Kodak Co.'s Sterling-Winthrop.

Advantage, Leschly. While following Kodak CEO George Sher to pay down debt and focus on the photo business, Leschly made a deal overnight will make SmithKline Beecham the global leader in the \$30 billion market for over-the-counter medicines, adding to its core brands such stalwarts as Phillips' Milk of Magnesia, Midol, and Stridex (tablets). Sterling's Panadol pain reliever alone produces \$250 million in sales in 64 countries.

More important than bulk, though, is geography. The U.S. OTC market, where SmithKline is strongest, has slowed to 6% annual growth or less. Overseas, where Sterling gets two-thirds of its revenue, growth is at least twice that. Sterling will build SmithKline's OTC presence in Western Europe to more dramatically in rapidly growing Eastern Europe and Asia. It "looks strategically like a good fit," says Lehman Brothers Inc. analyst Stewart Perkins.

RESCRIPTION SWITCH? SmithKline's bet is twofold. First, Leschly hopes to use the combined companies' expanded distribution network to lift sales across the product line. More intriguing, though, is his gamble that the OTC category will grow ever more important as European governments, hard-pressed to pay prescription-medicine bills for their citizens, switch more prescription drugs to OTC status.

Britain's government, for example, is currently pondering OTC approval of nine popular prescription drugs, which would

shift the bulk of the purchase cost to consumers. Such switches are expected to increase, making distribution such as Sterling's crucial. SmithKline could use the Sterling network, for instance, to boost slow sales of its Tagamet 100 heartburn remedy, which began selling in Britain in May.

Leschly has grander designs for his

Before he attempts such ventures, though, Leschly has to get costs down. Sterling's price tag, at three times sales and 18 times earnings, is modest compared with other recent drug deals. But it will leave SmithKline with \$5 billion in debt, about half its annual sales. The company is setting aside some \$750 million for a restructuring that could threaten thousands of jobs over the coming three years. "We don't need all the overhead we have," Leschly says. Executives want to boost the operation's pre-tax profit margin to 20% in that time—quite a stretch, since SmithKline's margins are now as low as 12% and Sterling's are little better.

ASSET SALE? But analysts say SmithKline should be able to make the deal pay in less than a year. Earnings may be only slightly diluted this year and start showing gains in 1995. Just how big the gains will be depends on what so-called nonstrategic assets Leschly sells. Among the potential candidates: Aqua-fresh toothpaste and a Beecham line of nutritional drinks sold in Britain.

FISHER CAN USE THE CASH TO CUT KODAK'S DEBT

Another, more likely,

cut: Sterling's Bayer aspirin. Although Leschly won't say, some SmithKline insiders and analysts think he may sell North American rights to Bayer, a low-growth item, to Germany's Bayer, which was forced to give up the product after World War I. Bayer bid unsuccessfully for the entire Sterling business and now says it will approach SmithKline to bid on Bayer. The product could be worth \$500 million to \$1 billion, say analysts.

The downside for SmithKline: By tying up capital in Sterling and its \$2.3 billion acquisition of Diversified Pharmaceutical Services Inc. in May, the company limits its ability to buy into prescription-drug operations, where margins are far higher. Leschly won't rule out more deals. "We are not panicking," Leschly told analysts on Aug. 30.

"We think we do have a healthy pharmaceutical business.... If the perfect opportunity comes up, and we see it can be done, we will look at it." With his OTC score, though, Leschly risks leaving SmithKline a pharmaceutical also-ran.

By Joseph Weber in Philadelphia, with Julia Flynn in London and Karen Lowry Miller in Bonn



CREATING AN OVER-THE-COUNTER GIANT

	SMITHKLINE BEECHAM	STERLING WINTHROP
1993 SALES	\$2.0 billion	\$1.01 billion
OPERATING PROFITS	\$245 million	\$162 million
BRANDS		
▶ GASTROINTESTINAL	Tums, Tagamet 100	Milk of Magnesia
▶ COUGH/COLD	Contac	Valda, Neo-Syneprhine
▶ ANALGESICS	Ecotrin	Panadol, Bayer, Midol

global network: He wants to sell the OTC medicines of rival drugmakers that have weaker presences in markets where SmithKline is strong. "There are plenty of major players [with which] we can develop relations," he says. Merck & Co. arranged a successful joint venture in 1989 with Johnson & Johnson. SmithKline already distributes certain products for Marion Merrell Dow Inc.

**When an airline has a young
pilots, attentive cabin crew,
ground technicians in tow,
concentrate on what's really**



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**ng fleet, experienced
w, and the pickiest
world, it's free to con-
mportant:**

Over the Tropic of Cancer, as seen from the Airbus A340 en route from Frankfurt to Rio de Janeiro

Commentary/by Seymour Zucker

THE FED COULD RAISE A LITTLE MORE KEYNES

You might call it a central banker's nightmare. The vice-chairman of the Federal Reserve Board declares unabashedly that he is a Keynesian. Moreover, he invokes the Nixon dictum of two decades ago that "we are all Keynesians now." Then he proceeds to admonish the guardians of the world's monetary system to stop fixating on inflation and start doing something about high unemployment.

It was no dream. That's what Alan S. Blinder, President Clinton's recent appointee to the Fed, told a high-powered audience of the world's central bankers and economists at a symposium last week in Jackson Hole, Wyo., organized by the Federal Reserve Bank of Kansas City. Blinder said that high European unemployment rates—8½% in Germany and 12% in France—were not structural in nature, as the European central bankers claimed, but rather remnants of the recent recession. He argued, therefore, that two to three percentage points could be lopped off the unemployment rates by easing monetary policy—without raising inflation.

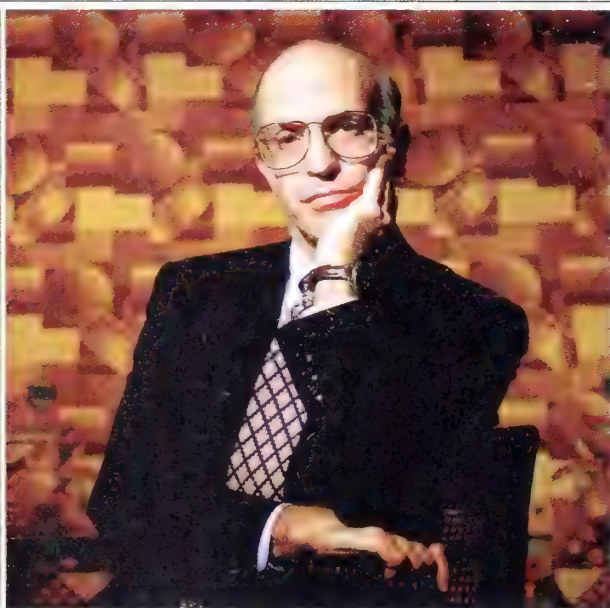
Should the Fed be practicing what Blinder is preaching to the Europeans? No, says the vice-chairman. Unlike Europe, U.S. unemployment, now at 6.1%, is almost to the point where easing money would ignite inflation. The implication was clear: The Fed was on the mark in raising short rates for a fifth time this year on Aug. 16, a move that Blinder supported in his first vote as a Fed member.

INFLATION GENIE. But Blinder may be wearing blinders when it comes to the U.S. economy. There's a convincing case to be made that U.S. unemployment could fall appreciably without letting the inflation genie out of the bottle. At issue is what economists call "the natural rate of unemployment." Here's the idea: Unemployment tends

to move toward its natural level, much as water seeks its own level. If employment surges—and pushes the unemployment rate below the natural rate—then wages and prices start to climb.

Blinder argues that today's unemployment is about at its natural rate. And Edmund S. Phelps of Columbia University told the conference that the natural rate had risen to 6.5%.

**BLINDER
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True, the natural unemployment rate is higher than it was 40 years ago. In the 1950s and early 1960s, economists put it at 4%. Because more women were working and unemployment benefits were rising (allowing people to stay jobless longer), the rate increased by the early 1970s to perhaps 5.5%. But the 1994 Economic Report of the President prepared by the Council of Economic Advisers, of which Blinder was a member until his Fed appointment in June, concluded that "there was little evidence of any increase since then." Listen to Blinder in January at the American Economic Assn. meetings: "Is the natural rate 6% or higher? We do not accept that. We use a number closer to 5.5%. And that makes a difference."

In fact, the natural rate may be even lower than that, as forces in the economy drive it downward. So much so that the U.S. economy may be less

inflation-prone than at any time since the 1950s. Over the past five years more than 5 million immigrants have crossed U.S. borders. This wave of newcomers is putting a lid on wages, even as total employment surges. And the big gains are coming in such service jobs as retailing, which is almost entirely nonunion. Wage pressures there are largely nonexistent.

Just as important is the effect of trade on the U.S. economy. True, imports come to only 12% of gross domestic product, but that understates their impact on wages and prices. Cheaper imports force down prices of domestically produced goods and thus keep wages in those industries from rising.

The indirect effect of foreign competition is also potent. The threat of production moving overseas keeps workers from demanding higher pay. Even such services as computer programming are taking the heat, especially from India, notes Albert M. Wojnilower of CS First Boston Investment Management. "The natural rate may be a lot lower than the current jobless rate, and the gain from letting it get there could be enormous," he says.

More evidence of this thesis: If unemployment is at the natural rate, then prices should accelerate. That's simply not happening. The consumer price index shows a 2.8% rise over the past 12 months, the same as in the previous year. And the core rate of inflation which excludes food and energy, rose 2.9% during the last year—down from 3.2% a year before.

All this suggests that employers can continue to grow smartly before wage and price pressures develop. The Fed should consider the advice its vice chairman gave the Europeans. A wee bit of Keynesianism is in order.

Senior Editor Zucker has covered the Jackson Hole confab for the past decade.



29 birthdays
4 weddings
A handful of graduations
3 housewarmings
1 Golden Anniversary

1200 gift ideas
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UN SOUND MIX: SO FAR, SONY'S ENTERTAINMENT WARES HAVEN'T MUCH AIDED ELECTRONICS GROWTH

SONY AMERICA'S NEXT ACTION HERO?

Jeff Sagansky would have an even tougher turnaround task than at CBS

From Mulholland to Melrose, Hollywood has been abuzz with speculation that Sony Corp. of America was about to become *The Mickey and Jeffrey Show*. The only question was, which Mickey and Jeffrey? Rumor No. 1 had Jeffrey Katzenberg, chairman of Walt Disney Studios, leaving the House of Mickey to take over Sony's troubled entertainment operations. Rumor No. 2 had Mickey Schulhof, the chief executive of Sony U.S., bringing in former CBS programming whiz Jeffrey F. Sagansky as head troubleshooter.

The second rumor turns out to be true. Executives at Sony said on Aug. 30 that Michael P. Schulhof was close to naming Sagansky president of Sony Software, umbrella company for Sony's movie, music, and electronic-publishing divisions. As president of CBS's entertainment division, Sagansky helped vault the network from last to first place in the Nielsen ratings. Now he faces an even tougher task.

Few of the synergies Sony sought between its entertainment and electronics businesses have materialized. Sony Pictures Entertainment, which consists of the Columbia and TriStar studios, is mired in a two-year slump that has dragged down the earnings of the Japanese parent company. And even Sony Music Entertainment, a reliable cash-spinner since Sony bought it from CBS Inc. in 1986, is in a fallow period, with eroding market share and few new artists (table).

Sony's woes are finally forcing Schulhof to take action. Insiders say the low-

key and precise executive, who led Sony drive into Hollywood, has become increasingly alarmed about the studio's tarnished image. And outsiders are starting to ask how he allowed it to get this way: "To the extent they have problems, says one leading investment banker, "you've got to start at the top."

Media watchers trace Schulhof's difficulties back to 1989, when Sony bought Columbia Pictures for a lofty \$3.4 billion. Trained as a physicist, Schulhof came through Sony's electronics business. Lacking experience in films himself, he followed the advice of then-Sony Music CEO Walter Yetnikoff to hire

Peter Guber for the studio. Schulhof followed Guber, a producer whose credits include *Batman*, to spend money like a millionaire Bruce Wayne. Among other things, Guber poured upwards of \$5 million into refurbishing Columbia's Century City lot. All told, Sony has invested \$5 billion in its Hollywood outpost.

BLAMING THE YEN. To his credit, inside say Schulhof decided to seek additional help nine months ago—informing Japanese bosses that he wanted an executive for strategic planning. Sagansky comes with strong credentials: He revitalized creaky CBS with classy shows such as *Northern Exposure*. And he has a Harvard MBA, which could be useful in Schulhof's effort to sell 25% of Sony's entertainment unit. Says Schulhof: "If I come, I wanted to make it clear to them that he'd have a broad playing field."

Still, Sony insists that Sagansky won't be a hands-on manager. Guber and Thomas D. Mottola, president of Sony Music, will continue to report to Schulhof. But given the studio's problems, many Hollywood executives believe that Sagansky will concentrate most of his energies there. Indeed, some say Schulhof is orchestrating Guber's departure. Guber, who recently signed a new five-year contract, declined comment.

Whoever ends up

SONY ENTERTAINMENT'S UPS AND DOWNS 1994 PERFORMANCE

SONY PICTURES	SONY MUSIC
FIRST-QUARTER SALES \$649 MILLION DOWN 4.3%	FIRST-QUARTER SALES \$1.09 BILLION UP 12%
KEY PRODUCTION UNITS Columbia, TriStar	HITS Mariah Carey's <i>Music Box</i>
MISSSES <i>Wolf</i> , <i>City Slickers II</i> *	MISSSES Spin Doctors' <i>Turn It Upside Down</i>
NEW RELEASES <i>Blankman</i> , <i>Wagons East</i> **	UPCOMING Pearl Jam, Barbra Streisand
ASSESSMENT Recovering from last year's <i>Last Action Hero</i> debacle, but still suffers from few hits and high costs	ASSESSMENT Sales are strong, particularly overseas, but it hasn't broken many new acts so far this year

*PRODUCED BY CASTLE ROCK ENTERTAINMENT **PRODUCED BY CAROLCO

DATA: COMPANY REPORTS, VARIETY

WHY MOST EXECUTIVES NEVER MAKE IT TO THE TOP.

In 1906, a young Russian immigrant found work as an office boy at Marconi Wireless Telegraph Company. He clawed his way up to Chief Inspector at the age of 22. And ever watchful for ways to advance his career, he decided to attend a demonstration of a new kind of circuit — one that could generate continuous electromagnetic waves. The young man returned to work, convinced he had seen the future. Memos flew. He described how music could be broadcast to hundreds of thousands of homes at once, and from a single transmitter. Every family in America would buy a “radio box.” And Marconi would manufacture and sell every one. Can’t you see there are millions to be made? The company’s more senior managers thought he had lost his mind. Besides, they were in the telegraph business.



Years later, Marconi Wireless became RCA, the Radio Corporation of America. And former office boy David Sarnoff became its president. As for those fellows he worked with, history lost track of them.

We are not all born to lead. Some of us would rather not even follow too closely. Now what about you? Consider for a moment the future you face; one in which your transportation decisions affect corporate performance as much as the decisions made in R&D, production, marketing, or anywhere else. We're the only transportation company in the country with truck, rail, and terminal operations stretching across all of North America. And companies that work with us are buying value where once they bought merely a service. The fact is, our system was built to create efficiency throughout your supply chain. In equipment management. Fuel consumption. Labor. And ultimately, your costs.

Still, corporate America uses intermodal transportation only half as often as it could. Is it a lack of cold-blooded ambition? A reluctance to change? Can't you see there are millions to be made? If you'd like to speak with us, we encourage you to call us at 1-800-279-6779. Because, while there are few David Sarnoffs in this world, it's best to assume there are five or six of them working for your competition.

Top of the News

ing the studio faces a daunting challenge. With 24 films so far this year, Sony has only an 11% share of the U.S. box office; it had 17.5% in 1993. Paramount Pictures Corp. has 14%, with half as many films. While Sony has avoided the losses of 1993's *Last Action Hero*, it has gotten tepid results from films such as *Wolf*.

These disappointments didn't help first-quarter revenue at Sony Pictures, which fell 4.3%, to \$649 million. Overall, Sony's pretax income dropped 39%, to \$238 million, on revenues of \$8.7 billion. Sony blames the high yen. Hitoshi Kuriyama, an analyst at CS First Boston (Japan) Ltd., predicts that Sony's full-year entertainment earnings will actually rise 79.5%. But the rosy comparison is possible mainly because of Sony's \$200 million write-down in 1993 to make up for *Last Action Hero*.

A bigger question is whether Schulhof will ever be able to propel consumer-electronics growth with his movies or music. True, some of Sony's gizmos are outpacing the competition. The company has sold 38,000 MiniDiscs so far this year, for example, while Philips Electronics has sold only 5,000 units of its rival Digital Compact Cassette. But experts doubt that's because the MiniDisc appeared in *Last Action Hero*: "I'm at a loss to provide any example of how video has boosted its sales," says Robert Alexander, an entertainment consultant.

WRONG NOTES. With those kinds of worries, Schulhof must be grateful for Sony Music, which has been a pillar of strength. Revenues rose 12% in the first quarter, with hits such as Mariah Carey's *Music Box*. And Schulhof has a solid CEO in Mottola: "From the day he came in,"

says Mottola, "Mickey has allowed me to be captain of this ship."

Yet even here, Sony is hitting some wrong notes. Insiders say Mottola is miffed because he doesn't understand Sagansky's role. Meanwhile, Sony hasn't broken as many new acts lately as rival Time Warner. Its U.S. market share has dropped from 17.2% in 1993 to 15.7% this year, according to market researcher SoundScan. Mottola says Sony will come back with new albums from Pearl Jam and Barbra Streisand.

That may be. But Sagansky's arrival signals that after 18 months of lousy news, Schulhof no longer wants to do it all alone. When it comes to running an entertainment giant, even a physicist can use a hand.

By Mark Landler in New York, with Robert Neff in Tokyo and Ronald Grover in Los Angeles

WILL WORK FOR ZILLIONS

Man-power n. 1. The power of human physical effort. 2. The total number of people available for work or service. 3. Hollywood slang: a terrific piece of manpower. Any high-priced executive looking for work.

Trust Hollywood to glamorize unemployment. Even as Walt Disney Co. announced that studio chief Jeffrey Katzenberg was leaving, Tinseltown was lionizing the departed. "A terrific piece of corporate manpower," proclaimed actor Warren Beatty, delivering the movie industry's assessment. "LITTLE CLUB." Katzenberg is by no means the only nice piece of Hollywood manpower looking for work. He soon will be joined in the search by QVC Inc. Chairman Barry Diller, who is scheduled to leave the home-shopping service in December. And next April, record mogul David Geffen will be free from the employment agreement under which he runs Geffen Records for MCA Inc. The billionaire then will be in the market to buy a media company. "We're our own little club," chuckles Diller.

The sudden rush of superstar executive talent is reminiscent of 1984, when Paramount Communications Inc.

let Diller go to Fox Inc. and Michael D. Eisner to Disney. Both Fox and Disney prospered mightily. This time around, Katzenberg appears to be the hottest property. The hyperkinetic executive is riding the success of the

"His dream job is to run Cap Cities," says one friend. Some media watchers believe the parent of the ABC network is looking for a CEO.

Not surprisingly, after QVC partner Comcast Corp. broke up his CBS merger plan, Diller says his next

move will likely be sans partners. "Owning 100% of anything makes decision-making easier," he says. One persistent Wall Street rumor has Diller making another offer for CBS. A rival studio executive predicts Diller will team up with

TCI President John C. Malone. Another QVC partner, to buy a majority piece of Sony Corp. record-and-film unit when the Japanese owners tire of the film unit's dismal performance. Then there are those who figure that Katzenberg and Geffen will team up. "I'd love it," says Geffen. "We could start a company and make a lot of money together."

They may have company. Rumors continue to circulate that Hollywood superagent Michael Ovitz may head a group of telephone companies seeking to buy a studio. Ovitz has long denied he's going anywhere. But if the rumor is true—well, that's one terrific piece of manpower.

By Ronald Grover in Los Angeles



MOGULS AT LARGE: SAGANSKY IS CLOSE TO A KEY JOB AT SONY; GEFFEN MAY BUY A MEDIA COMPANY; DILLER PLOTS HIS NEXT BID FOR AN EMPIRE; AND KATZENBERG CONTEMPLATES LIFE AFTER MICKEY

movie *The Lion King* and Broadway's *Beauty and the Beast*. Hollywood rumor had Katzenberg headed to Sony Corp., but he wasn't interested, and the offer went to Jeffrey F. Sagansky.

SANS PARTNERS. If not Sony, what next? Katzenberg, taking a busman's holiday at Walt Disney World, is said by industry sources also to have had overtures from CBS Inc. and TeleCommunications Inc. He says he won't consider anything until after his late-September official departure from Disney—but then is open to all offers.



Wednesday, August 31, 1994



Thursday, September 1, 1994

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In Business This Week

EDITED BY KEITH H. HAMMONDS

WHISTLE-BLOWERS ARE SUING THE RTC

Just as the Resolution Trust Corp. seemed to be putting last month's congressional Whitewater hearings behind it, the agency is under attack again. On Sept. 1, one former and three current RTC employees were expected to file suit in a Washington federal court charging the RTC with "a vicious campaign of retaliation" against agency employees blowing the whistle on fraud and mismanagement. Two of the plaintiffs testified last fall in a Senate hearing on RTC whistle-blower complaints. That hearing prompted Senate Banking Chairman Donald Riegle Jr. (D-Mich.)

to request a review by the Justice Dept. of the charges of harassment and abuse. The RTC declined to comment.

AUSTERITY STARTS AT THE TOP

When Scott Paper's directors walked into the boardroom in mid-July, they collected their usual \$1,000-a-meeting fee. But after an impassioned speech by new Chairman Albert Dunlap on the need to link pay to performance, all returned the checks. In exchange for 1,000 shares of Scott stock a year, now trading near 65, Dunlap persuaded the nine outside directors to dump a lucrative basket of goodies, including meeting fees, a \$20,000 annual retainer, and retirement benefits. The decision was made public on Aug. 30. Dunlap, who has shaken up the sleepy company since arriving in April of this year, contends that "lots of boards are even worse than this. It's outrageous."

BEANTOWN'S BROWN BOUNCES BACK

Is Boston's real estate market finally waking up? Office vacancy rates are falling, demand for apartment rentals is robust, and Harold Brown, Boston's onetime real estate czar, is back. When the region's economy collapsed, Brown and his empire of 160 buildings landed in bankruptcy court owing \$675 million to 39 lenders. But on Aug. 25, Brown won approval for the last leg of his restructuring. With the plan, Brown preserves two-thirds of his empire, but will sell or refinance a total of 60 buildings.

IVAX SWALLOWS UP ZENITH

There's a new giant in the no-name-drug business. On Aug. 29, IVAX announced that

HEADLINER

AND THE SAX PLAYED ON

Philippe Kahn still has a job. Good news, certainly, for the flamboyant founder and chief executive of software maker Borland International. Not so good, though, for the College Retirement Equities Fund (CREF) and the California Public Employees' Retirement System (CalPERS)—the two Borland investors that had declared their opposition to Kahn's reelection as chairman.

Kahn has come under increasing attack in the past year. After reporting a \$70 million loss in Borland's fiscal year ended Mar. 31, the board revealed that Kahn was awarded favorably priced options for 1 million shares.

Kahn also had to reimburse the company for private use of a company-leased plane and for production of a music compact disk on which Kahn played sax.



But at Borland's annual meeting on Aug. 30, board members announced to oust Kahn. Nevertheless, 95% of the votes cast

favoring the chairman's reelection, Borland says. No shareholders spoke on the issue, and CalPERS said afterward it was just expressing dissatisfaction. For now, at least, Kahn isn't playing the blues.

By Richard Brant

CLOSING BELL



A \$1 BILLION DEAL, BUT LITTLE CHEERING

Viacom delivered on Chairman Sumner Redstone's brash prediction that it would sell Madison Square Garden for \$1 billion. On Aug. 28, it announced that Cablevision Systems and ITT would jointly plunk down \$1.08 billion for the famed New York arena, with its sports teams and cable network. On Aug. 31, it sold a station to Fox for \$200 million. But Viacom's good news was muted by continuing declines in its proposed merger with Blockbuster Entertainment, which some shareholders will dilute their holdings. Viacom's Class B stock didn't budge from about 33.

INFORMATION SYSTEM INC.

it was planning to acquire Zenith Laboratories in exchange for about \$600 million in stock. Together, the companies will have a stable of 63 generic drugs and more than 40 applications pending before the Food & Drug Administration. The price is high: more than six times Zenith's sales. But IVAX needs the clout in order to compete in managed care. "This is an important step in the long-run strategy for IVAX," says Viren Mehta of Mehta & Saly. Conveniently, the purchase will also remove Zenith's new rival to IVAX's version of verapamil, a popular hypertension drug.

ALL IN THE HAFT FAMILY

Retailing magnate Herbert Haft may be eating Thanksgiving dinner alone this autumn. Last year, Washington's Haft declared war on his wife, Gloria, his eldest son, Robert, and his daughter, Lin-

da—settling with them in Maryland for \$80 million and an agreement that they all leave Dart Group, the family-run company. Now, Haft, 74, is at odds with his 35-year-old son, Ronald, his last remaining heir. Ronald, Dart's president, claims his father is improperly raiding company coffers to pay the family settlement. Herbert says Ronald is trying to gain control of the company and, at one point, threatened to burn Herbert's house down. The feud is being mediated by an outside mediator.

ET CETERA . . .

- Philip Morris hiked its dividend by 20%, and will buy back \$6 billion of stock.
- Fujitsu didn't infringe on a basic Texas Instruments copyright, a Japanese court ruled.
- Stephen Wolf, late of United Airlines, will advise Air France on restructuring.
- New Cheerios. New Wheaties. General Mills says it wants "crispier" cereals.

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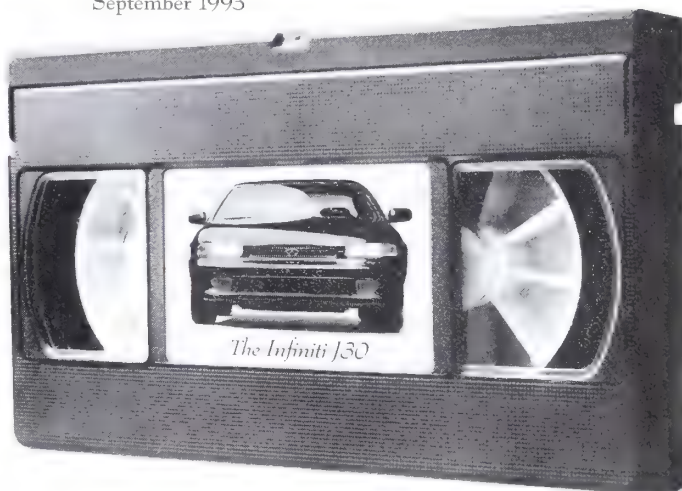
Car and Driver
September 1993

"...an excellent performer in all situations, from high-speed merges to passing."

New York Post Auto Saturday
April 24, 1993

"A highly refined rear-drive sedan, absolutely dripping with luxury."

Road & Track, 1993
Complete Car Buyer's Guide



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Car and Driver
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PHIL GRAMM: A SLASH-AND-BURN ARTIST'S WHITE HOUSE QUEST

He won't win any congeniality contests. His combative style turns off colleagues. Even his wife says that when she met him, "My first reaction was, 'Yuk—what a jerk.'" Still, Senator Phil Gramm (R-Tex.) thirsts for the Presidency. His ambition to lead a crusade for less intrusive government explains why Gramm has become one of Bill Clinton's chief tormentors on Capitol Hill.

The 52-year-old former economics professor vows to use slash-and-burn tactics on what's left of the President's 1994 agenda. And as head of the National Republican Senatorial Committee, Gramm is leading the charge to elect at least four more Republicans to the Senate this fall—and stymie Clinton's initiatives for the remainder of his term. That's why, though he's not up for reelection, he's out stumping for candidates during the Labor Day recess.

The GOP's 1992 White House loss convinced many strategists that the party needed an activist government agenda to win. Not Gramm. The GOP's Dr. No is instead prodding colleagues to kill every Clinton program in sight.

It was Gramm who persuaded Senate Minority Leader Robert J. Dole (R-Kan.) to try to kill Clinton's crime bill—a strategy that crumbled when GOP moderates defected. Yet, even in failure, Gramm found victory: By prolonging debate, he blocked passage of major health reform this year. "The President has failed to sell his programs to the American people," says Gramm. "The logical thing to do is to have an election in November and start over next year."

That's mighty convenient for Gramm, since he figures the mid-term elections will be disastrous for the Democrats. And Gramm can claim credit: He has been to 38 states this year, raising as much as \$350,000 a day for GOP candidates.

Gramm's travels also help forge his links to the donor net-

work, letting him amass an \$8 million war chest of his own three times that of other Presidential rivals. Colleagues grumble that he's a self-promoter. "Gramm is acting absolutely, uncontrollably on personal ambition," says a GOP Senate aide.

To this charge, Gramm pleads *nolo contendere*. "It's a valid criticism, but what's wrong with all this helping me? I sure hope I get more than saddle sores." And if the Senate goes Republican, "maybe some people will like me."

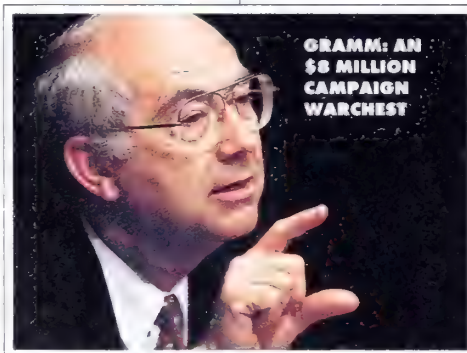
Will the GOP faithful like Gramm enough to nominate him '96? His folksy homilies don't electrify party cattle show and his speech at the '92 GOP convention was a dud. His PhD in legislative gridlock is a reminder that he's a creature of the Capital Beltway. And his economic conservatism hardly stands out in a crowded GOP field.

DEMOLITION KING? Still, opponents who have tangled with Gramm warn that it would be a mistake to discount him. "People don't understand how shrewd he is," says Clinton adviser Paul E. Begala, whose candidate, Lloyd Doggett, was trounced by Gramm in a 1984 Senate race.

For Gramm to win the right to challenge Clinton, party pretender that chief rivals—Dole, 71, and former Housing & Urban Development Secretary Jack F. Kemp—would have to fizzle. Ex-Defense Secretary Richard B. Cheney makes Gramm look charismatic. Former Education Secretary Lamar Alexander, distrusted by the right, and few give former Vice-President Dan Quayle a real chance.

The way Gramm sees it, if he keeps dynamiting Clinton "welfare state" programs, he'll become a hero to party stalwarts. But unless he constructs a compelling agenda for the country, it's unlikely the skillful demolition expert will be able to blast his way into 1600 Pennsylvania Avenue.

By Douglas Harbrecht



GRAMM: AN \$8 MILLION CAMPAIGN WARCHEST

CAPITAL WRAPUP

CONGRESS

The truth may have been the first victim of the crime bill Congress passed on Aug. 26. Remember the bitter confrontation between Democrats and Republicans over how much to spend on alleged pork? It turns out that a week before the Senate passed the measure, lawmakers quietly agreed to spend the very money that had parked their battle. On Aug. 19, the Senate took a break in its anti-crime debate and voted 88-10 for a routine fiscal 1995 spending measure. It included \$2.4 billion for nearly all the "wasteful" programs the GOP was maligning—antigang efforts, a juvenile mentoring

program, and drug-abuse prevention.

That spending bill was a first-year downpayment on the \$30 billion, six-year crime measure, which requires Congress to vote annually to release funds. Unlike the deeply partisan crime measure, the spending bill was backed by all but two Democrats and most Republicans, including Minority Leader Bob Dole of Kansas and New York's Alfonse M. D'Amato. Just days after voting to spend the money for the fiscal year beginning Oct. 1, D'Amato took to the floor, attacking the "pork" in the crime bill with his version of "Old MacDonald." President Clinton and Democrats played along with the charade. Though they cried that a de-

feat would handcuff efforts to curtail crime, they knew Congress had already approved the first batch of money.

If anyone has real cause to cry, it would be those state and local officials who were supposed to be the beneficiaries of federal largesse. Because of tough spending caps enacted in 1990 and 1993, the crime bill will have to be funded largely by offsetting cuts in other domestic programs. That means many cities and states will get new anticrime money just as they lose an equal amount of federal grant assistance, much of it used for—what else—crime prevention. "It's almost a shell game," admits one abashed Senate aide.

By Howard Gleckman

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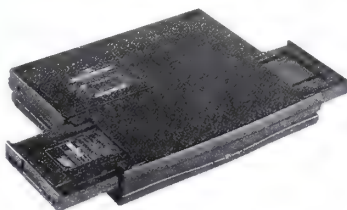
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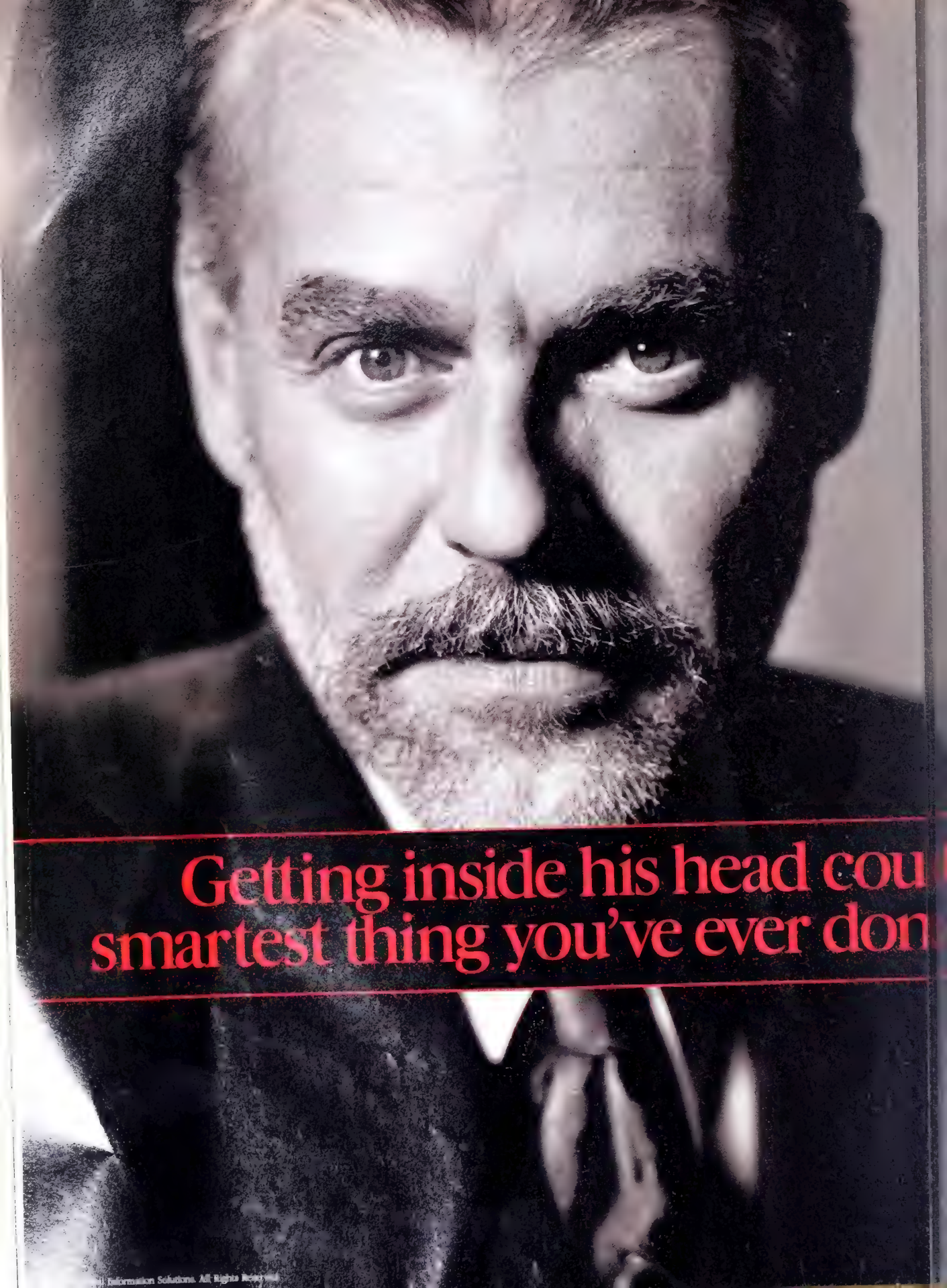
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WALTZ OF THE MEDIA GIANTS

With Europe's market set to explode, empires are teaming up

European television, as any traveler knows, offers pretty slim pickings: game shows, movie reruns, talking heads. But thanks to new digital technology, the TV wasteland is about to bloom with fresh possibility. By the end of 1995, new digital cable and digital satellite services are expected to revolutionize the media landscape. For starters, the number of TV channels available to broadcasters will swell from a handful to more than a hundred. Digital broadcasting will also speed the development of future interactive and multimedia services.

No wonder Europe's media giants are joining forces to grab the lion's share of infrastructure, programming, and distribution. In a half-dozen recent alliances that cross borders and span industries (table), companies are vying for a fat slice of what promises to be a bigger TV-viewing market. On Aug. 25, Germany's Deutsche Telekom—the monopoly telephone company and the king of European cable, with 13 million subscribers—announced that Media Services, its joint venture with publishing superpower Bertelsmann and Bavarian media mogul Leo Kirch, is planning trials of interactive TV in 6,000 Berlin homes later this year. A week earlier, Dutch electronics giant Philips Electronics—best known for TVs and video recorders—announced plans to offer pay-per-view services to cable operators Europewide, with U.S. partner Graff Pay-Per-View Inc., starting in September in Holland. "Europe's couch potatoes are about to become couch commanders," says Neil Blackley, media analyst at Goldman, Sachs & Co. in London.

Revenues from key segments of the TV industry are expected to grow from \$110 billion to \$150 billion over the next five years (chart). Everyone from state-

owned telephone companies to consumer electronics makers is investing in cable networks, since cable's broad bandwidth is best suited to carry interactive TV and multimedia services. And although most cable networks are still analog, operators can fairly easily convert their equipment to send and receive digital signals—and charge their customers for the decoder box.

CRITICAL MASS. In a bold bid to become Europe's largest cable operator, Philips Media also has teamed up with United International Holdings in the U.S., and they plan to set up systems throughout Europe. "The European market is the richest market after the U.S.," says Scott Marden, president and CEO of Philips Media in New York. And rivaling Philips' effort, France's Canal+ and Bertelsmann are investing \$360 million to develop new pay-TV service throughout Europe via satellite and cable. Michael Dornemann, Bertelsmann's chief of worldwide entertainment, sees Europe as a testing ground for increasingly global products.

Existing players hope to gain critical mass through alliances to gain access to a larger base of subscribers. Subscriber fees for cable and pay-TV services generate the bulk of revenues in the European TV market, where commercial advertising is less developed. With so much new competition, capacity, and programming, pricing for the new services is still up in the air. But rapid

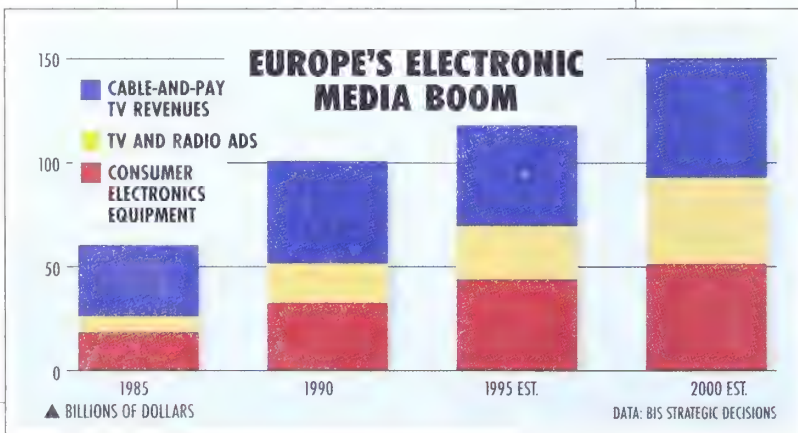


expansion is initially likely to mean lower revenues for any one supplier. "For several years, we will face a sort of paradox of more viewers and lower revenues," says Marc Tessier, an executive vice-president at Canal+, Europe's largest pay-TV broadcaster. That's why a wide subscriber base is so desirable.

Besides competing with one another, cable operators are head-to-head with satellite technology. In contrast to the U.S., Europe has already seen big investment in direct-broadcast satellite technology, which digital promises to make even more competitive. Digital

satellite's new channels could eclipse the future growth of cable in countries such as Britain and France where cables are underdeveloped. Meanwhile, in Belgium, Holland, and Germany, where cable is dominant, the arrival of digital satellite broadcasting will provide access for new entrants.

The race to control the satellite airwaves





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Venture

Europewide pay-per-view, video on demand, and interactive TV services, starting in Holland in September

A new channel called Super RTL aimed at children, starting in Germany in 1995

Investing \$360 million to develop and distribute digital pay-TV services Europewide

Formed Berlin-based Media Services to offer pay-TV and interactive multimedia services starting in 1995

Launched Multivision in May, the first French pay-per-view TV, and are developing multimedia services

Purchased stakes in Bertelsmann's ailing VOX channel in Germany

GAIL EDMONDSON

**CONTROL ROOM AT CANAL+: THE
NUMBER OF TV CHANNELS AVAILABLE
TO BROADCASTERS WILL SOON GO
FROM A HANDFUL TO MORE THAN 100**

ready on. European media giants like Rupert Murdoch's British Sky Broadcasting and Canal+ want the European Union to back proprietary systems that encode the digital signals beamed to TV sets. But public broadcasters and smaller rivals are fighting for an open interface that would allow any new player to develop services. Once a few big companies take control of the infrastructure, they argue, it will be difficult to change the way markets are carved up.

USTING BARRIERS. European Union regulators have asked the Geneva-based Digital Video Broadcast Group (DVB) to develop recommendations to regulate the market. The association of 30 broadcasters, producers, and government officials is likely in September to agree to support development of both proprietary and open systems. But in reality, admits Albrecht Ziemer, a DVB committee co-chairman, that probably means a handful of large players will rush into the market with proprietary systems, making economically risky for newcomers to try competing. Besides challenging regulators,

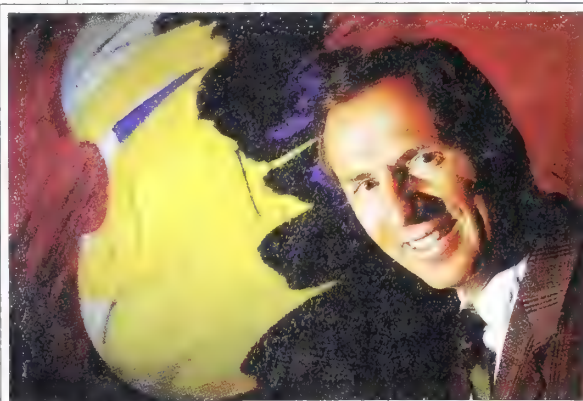
digital TV may also bring down stubborn cultural barriers within and around Europe. Alliance partners already are plotting to acquire, develop, and control programming that can be marketed to the widest possible audience. "It's impossible to launch a new TV service and expect it to be profitable on a national basis. We have to consider Europe as a whole now," says Tessier of Canal+.

A European Union directive currently requires broadcasters to maintain at least 50% European programming. At first, however, a lot of the new channels are likely to carry considerable

low-cost Hollywood programming, since developing European-based programs is 10 times more expensive than buying rights to U.S. TV and film fare. Walt Disney Co. already has begun developing children's TV programming for several European countries, and on Aug. 23 announced a joint venture with Luxembourg-based CLT to launch a new children's channel in Germany next year. As digital services become more profitable, European companies will invest more in local programming, says Tessier.

Despite the stampede toward a new digital-TV future, market researchers and CEOs agree the payoff is years away. Cable operators in Britain still show a loss when voice-phone revenues are stripped from total operations. As a result, partners in the current spate of alliances could drop out or reshuffle in coming years. For the time being, though, the participants are betting that bigger will be better when digital infotainment hits Europe's TV screens.

*By Gail Edmondson in Paris,
with Patrick Oster in Brussels*



DORNEMANN: SEEING THE WORLD AS ONE BIG AUDIENCE

CHINA

RON BROWN'S 'LOVEFEST' IN BEIJING

China threw the U.S. billions in deals and made a gesture on human rights

They came. They schmoozed. They cut deals. With 24 American CEOs in tow, Commerce Secretary Ronald H. Brown made billions worth of rain for U.S. companies on his August China trip. Chinese officials, grateful for his backslapping "commercial diplomacy," responded by agreeing to resume human rights talks. Brown's visit, the first since President Clinton renewed China's most-favored-nation trade status in June, contrasts with the disastrous trip in March by Secretary of State Warren M. Christopher. This time, says a U.S. official, the meetings were a "lovefest."

For an Administration plagued by foreign policy crises, Brown's trip is shaping up as a much needed success. U.S. companies signed over \$6 billion in deals, many for giant infrastructure and manufacturing projects. The test is to turn the good feelings into more progress. Washington wants cooperation on a number of irritants such as China's growing trade surplus. The U.S. will hold out for concessions before approving Beijing's application to enter the General Agreement on Tariffs & Trade.

LEGAL AID. The deals assure U.S. companies of a key role in China's industrial development. General Electric and Westinghouse announced power deals worth at least \$200 million, while Boeing won \$1 billion in airline orders. IBM said it was forming a joint venture to develop an information superhighway. More announcements are expected, possibly including a coveted minivan contract for Chrysler Corp. Moreover, China agreed to regular meetings on areas such as telecommunications, automobiles, the environment, providing a window for future

deals. The U.S. also pledges more assistance for developing and promoting commercial law in China.

While editorialists in the U.S. have excoriated Brown for kowtowing to China, human rights activists in Hong Kong have reacted with restraint. Chinese dissidents "have known for some time that they cannot count on America," says one Chinese activist. Moreover, with the succession to Deng Xiaoping, 90, so un-

clear, there's little influence any U.S. policy could have on Beijing's nervous leaders, says John Kamm, a U.S. businessman active in human rights issues. But now "we may get some improvement along the margins," says Kamm.

Markets reacted more emphatically to the visit. Hong Kong's Hang Sen index rose 2.5% on Aug. 31 to close at 9,926, capping a 9% jump over five days. The rise reflected "the fundamental change in the relationship between the U.S. and China," says Eugene Law, director of research at Standard Chartered Securities Ltd. in Hong Kong.

After the euphoria fades, formidable obstacles will remain. They include China's trade surplus with the U.S.—\$2 billion last year—American demands for greater protection of intellectual property rights, and China's GATT application.

U.S. leverage over GATT won't do much in the human rights talks. And some analysts doubt the Chinese will follow through on some of the commercial pledges made to Brown. "You don't know how many of the deals will really happen," says Nick Amesworth, senior equity salesman with Morgan Stanley Asia Ltd. in Hong Kong.

Nonetheless, Brown has broken the logjam. More commercial diplomacy is on the way. In October, Export-Import Bank Chairman Kenneth D. Brody will visit China to back up many of the deals with cash. Ex-Im officials expect to approve financing for up to \$1.1 billion in export contracts to China this year, a 40% increase from 1993.

To prove that constructive engagement works better than confrontation, though, Clinton has to do more. He won't have much time. The annual Asia Pacific Economic Cooperative summit will be held in November in Indonesia. Then the President will confront face to face with China President Jiang Zemin. If then, Clinton hopes he can show that his new policy does more than bring hon-

dollars to U.S. companies.
*By Dave Lindorff
Hong Kong, Lynne Curry
Beijing, and Douglas H.
brecht in Washington*



FOR AN ADMINISTRATION BESET BY FOREIGN POLICY
CRISES, BROWN'S TRIP WAS A MUCH-NEEDED SUCCESS,
BUT MANY POINTS OF TENSION REMAIN



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INSTRUMENTS FOR PROFESSIONALS

CASTRO JUST MIGHT REACH FOR THE OLIVE BRANCH

Something's got to give. The Clinton Administration's policy of warehousing Cuban refugees at Guantánamo while trying to further isolate the Castro regime is looking more and more unsustainable. That's partly because the refugee flow isn't going to dry up. Guantánamo will fill up even if the exodus ebbs to 300 to 500 a day. And rising discontent could upend Clinton's strategy by sparking a riot. "The immigration threat is one of the few Castro has left," says Gillian Gunn, director of the Cuba Project at Georgetown University. "He is unlikely to entirely shut down the flow until he gets the U.S. to address some aspect of the overall relationship."

The main political target of Clinton's policy, of course, is not Castro but Florida with its Democratic governor, Lawton Chiles, who fears that a refugee wave could sink his reelection chances. That's why Clinton hopes to keep a lid on things at least until November. So he is offering Castro an escape valve for some 20,000 legal Cuban immigrants annually, long authorized by U.S. law, in return for Castro's help in curbing the rafters. For Castro, an orderly outflow of discontented Cubans would ease internal tensions.

"FIRST STEP." Beyond such a limited quid pro quo, Clinton is wary of taking additional steps. Further dealings with Castro could cause the Cuban-American right wing to turn on him—and Chiles—in fury.

Still, Secretary of State Warren M. Christopher's recent statement—that the U.S. would consider easing Cuba's isolation in response to positive steps by Havana—could mark the beginning of a path through the deadlock. Strictly speaking, Christopher broke no new political ground: He was quoting the 1992 Cuban Democracy Act, which tightened the U.S.

embargo against Cuba but offered just such a limited olive branch. The catch is that Castro must make the first move.

Some experts think Castro may be ready to do that, starting with steps toward a freer economy. In 1993, he launched such reforms but pulled back. But Raúl Hinojosa Ojeda, a visiting scholar at the Inter-American Development Bank, says Castro's economic advisers now are much like those the U.S. has worked with in Eastern Europe. "I have never seen Cuba more ready and willing to contemplate [reforms]," he says. "This would be the first step toward political liberalization."

In Washington, there is growing political support for engagement. Lee H. Hamilton (D-Ind.), chairman of the House Foreign Affairs Committee, and Richard D. Lugar, ranking Republican on the Senate Foreign Relations Committee, are among legislators advocating this. "It's important that we begin to spell out what we are prepared to do to reward Cuba for moving toward democracy," Hamilton says.

Such views, along with editorials in influential U.S. newspapers calling for steps from negotiations to outright repeal of the embargo, give Clinton a measure of political cover for shifting course.

Cuban officials were to mention in the



CUBANS IN GUANTANAMO: RISING DISCONTENT

immigration talks that they were mulling a political amnesty, could be hard for the Administration not to respond.

What both the Haitian and Cuban crises suggest is that the Administration has let larger U.S. foreign-policy interests be sidetracked by parochial concerns because it hasn't figured out what its long-term objectives are. In late August, Commerce Secretary Ronald H. Brown was in China wooing Beijing despite China's high-profile human-rights abuses. If the U.S. can court Chinese business, it may be increasingly difficult for Clinton to refuse even to talk to Havana.

By Amy Borrus in Washington, with bureau reports

GLOBAL WRAPUP

OPENING SOUTH AFRICA'S MARKET

President Nelson Mandela's government plans to open key industries rapidly to global competition, sharply reversing the former socialist leanings of Mandela's African National Congress. Trade & Industry Minister Trevor Manuel proposes to slash textile tariffs to half the levels allowed by the General Agreement on Tariffs & Trade within eight years while lowering duties on autos to 30%, instead of the 45% sought by carmakers. He also vows to cut export subsidies for manufactured products such as steel.

Manuel warns that drastic industrial restructuring is needed to make South

Africa's economy competitive after decades of state intervention, partly designed to counter sanctions against the apartheid regime. However, Manuel is risking clashes not only with industrial lobbies but with the ANC's labor-union backers. The textile workers' union is threatening widespread protests if the government does not back restructuring plans devised last year by the union and employers. That blueprint calls for \$1 billion in state aid—far more than the government is willing to provide.

ULSTER'S HOPES RISE

The halt to violence declared by the Irish Republican Army on Aug. 31 brought a ray of optimism to North-

ern Ireland's 1.6 million war-weary residents. But barely. Even if the cease-fire holds, the next steps will be even more problematic—from withdrawal of British troops to negotiations on what kind of government to form, and ultimately, whether to join the Irish Republic or remain part of Britain.

One immediate beneficiary could be British Prime Minister John Major, who staked his political future on allowing secret talks to settle the 25-year-old conflict. Northern Ireland residents also could benefit from aid packages being prepared by the U.S., the European Union, and Britain to underpin the peace process.

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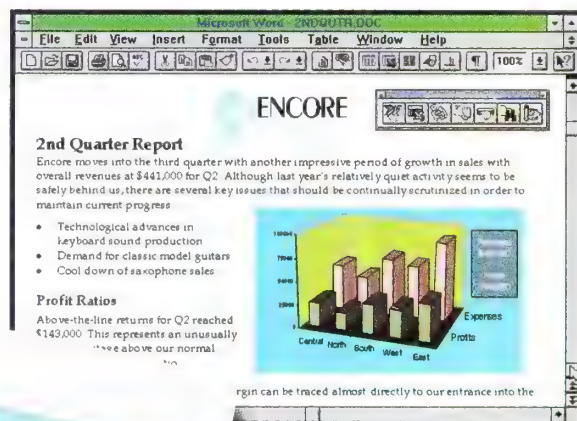
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THE ECONOMICS OF AGING

WHY THE GROWING NUMBER OF ELDERLY WON'T BANKRUPT AMERICA

*Grow old along with me!
The best is yet to be,
The last of life
for which the first was made.*

—Robert Browning, 1864

Americans are getting older. The Woodstock generation, the roughly 76 million baby boomers who were born from 1946 to 1964, is going gray. The elderly are living longer. And Americans seem gripped with foreboding about aging. Growing old means years wasting away in nursing homes, debilitated by chronic illness—as Shakespeare writes, “sans teeth, sans eyes, sans taste, sans everything.”

The visions grow darker on fears that spendthrift Americans aren't saving enough and that when they retire, their living standards will plunge. Social Security payments may not be there to help out as the system buckles with too few workers supporting too many retirees. And the swelling ranks of the elderly will send medical costs spiraling out of control until “we will have to limit health care for the elderly,” says Daniel Callahan, director of the Hastings Center for bioethical research. Little wonder that intergenerational animosity has become a staple on talk radio. These days, the mantra “we can't afford it” echoes from Senate hearing rooms to corporate boardrooms. Altogether, the worst is yet to be.

But there are strong reasons to believe that the age apocalypse won't arrive. Like your grandfather's Oldsmobile, the image of an America debilitated by age belongs to a different economy and an earlier generation. Instead, a series of broad, mutually reinforcing changes in the U.S. economy will make an aging population much more of an economic asset than before.

FIT FOR LIFE. One striking transformation is how companies now use information technologies to raise productivity. And higher productivity, the fundamental source of economic wealth, makes it easier to fund the Social Security and health-care bills that are squeezing America's wallet today. Another change is that people can be more productive far longer in an information-and-services economy than one dominated by factories and heavy industry. Healthier lifestyles and medical advances should also postpone disability among the elderly. Says Dr. Sanford Finkel, director of the Buehler Center on Aging at Northwestern University: “People who used to be considered old at 65 are usually still in their prime at that age today.”

Boomers are also better off than their parents. Their real median household income and wealth is higher than

their parents' at comparable ages. Billions of dollars are pouring into retirement savings plans and mutual funds as boomers reach those sober ages where savings typically rise. “Those who say it is going to be awful don't understand that boomers have multiple sources of income and multiple retirement packages for husbands and wives,” says Charles Longino, demographer-gerontologist at Wake Forest University.

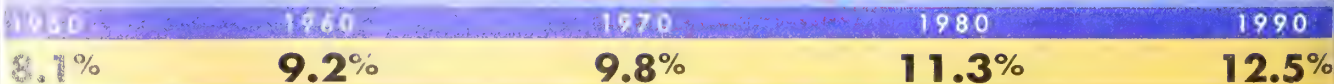
Certainly, the numbers heading for Golden Pond are staggering. Today about 1 in 8 Americans is 65 years or older, compared with 1 in 25 at the turn of the century. By 2030, 1 in 5 Americans will be elderly. And senior citizens are around for a lot longer. Life expectancy at birth was 47 years in 1900; in 1993, it reached 76 years. For those reaching age 65, average life expectancy for men is projected to rise from a current 81 years to 85 in 2040; for women it's 85 and 88. The fastest-growing segment of the population is the so-called oldest old—those 85 years or more.

To be sure, not all these senior citizens will be physically and financially healthy

AGING AMERICA

**U.S. POPULATION
AGED 65 AND OVER**
MILLIONS OF PEOPLE

**ELDERLY'S SHARE OF
TOTAL POPULATION**
PERCENT



"IT'S THE BEGINNING"

Carl Rowan, 85, sold his Butte (Mont.) restaurant—then went to work as a greeter at the local Wal-Mart

n retirement. Especially vulnerable are less educated workers, who have had their incomes hammered by global competition and high-tech investment. Also at risk are the growing ranks of single-parent households, typically headed by a woman. Both groups are far less likely to have a pension plan and own their home. Indeed, while some twentysomething activist groups, rebelling against costly federal benefit programs for the elderly, fear up for a generational showdown, the economy's real fault line is not the generation gap but the growing split between rich and poor. And Washington's altering drive for overhauling the health-care system raises concern for prospects of bringing medical inflation under long-term control.

NEW ORDER. Nevertheless, the positive forces at work are powerful. Among them is a stronger economy. Thanks largely to the information revolution, the U.S. economy can ramp up output without triggering an inflationary surge. Companies are spending huge sums on computers, software, and telecommunications gear—the foundations of the information economy. Real business expenditures on all forms of information technology have soared by nearly 70% over the past three years, says Stephen S. Roach, economist at Morgan Stanley & Co. The result: greater efficiency and lower prices. Over the past two years, gross domestic product per worker has risen at a 1.5% annual pace. And consumer inflation is running at a tepid 2.8% yearly rate. Strong growth takes care of a lot



2000	2010	2020	2030	2040
12.8%	13.3%	16.4%	20.1%	20.7%

Cover Story

of problems by raising living standards. In a self-reinforcing cycle, higher productivity boosts real incomes and corporate profits, stimulating investment and savings, and so forth. For example, with long-term productivity expanding at a 1.5% annual rate, gross domestic product per elderly person in 1987 dollars rises from \$158,000 in 1993 to \$194,000 in 2010 and to \$207,600 in 2050. By contrast, at

Japan, because their populations are aging even faster than that of the U.S., and their economies are less flexible.

Workplace changes are part of the demographic transformation, too. People will be working longer, and older people will contribute more to economic growth. Clearly, the information economy will ease the transition to longer working lives. Working with computers

shift to longer work lives traumatic. The median retirement age declined from age 67 to 63 from 1950-55 to 1985-90. Yet it's unrealistic for people to expect to spend almost a third of their lives in retirement. Already, the Social Security retirement age for full benefits is slated to increase to 67 in 2022, vs. the current 65. And an aging workforce will compel companies to rethink virtually

every aspect of how they organize business in order to tap into the knowledge of their older workers while keeping promotion opportunities open for younger employees. The payoff will be huge though. "Just as the economy was blind to the potential of women and work," says Betty Friedan, author of *The Feminine Mystique* in 1963 and *The Fountain of Age* in 1993, "the idea that people over 50 are somehow on their way to senility is blindness to the potential of the last third of life."

PAYCHECK PEAK. Just ask Carl C. Rowan, 85. After owning and operating Gamer's Confectionery, a restaurant in Butte, Mont., for 55 years, Rowan sold the business in April, 1993. Everyone expected Rowan to settle into a comfortable retirement, but then Kent Parsons, manager of the local Wal-Mart, offered Rowan a job as a Wal-Mart store greeter. Rowan now works 30 hours a week, makes \$5.45 an hour, and takes \$50 out of each paycheck to buy Wal-Mart Store

Inc. stock through an employee stock purchase plan—and Wal-Mart matches 15% of his contribution. "It's exciting," said [when I sold Gamer's] that this isn't the end of Carl Rowan, it's the beginning." Parsons wants to have a stable workforce whose age averages 40. "It makes for a more stable workforce, a more consistent workforce," he says.

Still, many economists and financial planners believe the American dream is withering away. For years, they say



NEW BLOOD

Immigrants will keep driving a young workforce, moderating the effect of aging

the 0.75% annual rate that holds for part of the 1970s and 1980s, GDP per senior citizen is 12% lower in 2010 and 35% less in 2050. Says Richard Suzman, chief of demography at the National Institute on Aging: "The growth rate of the economy is a far more important variable than the simple age of the population." And high growth rates in the U.S. do more to ease any burdens from an aging population compared with other major industrial nations, such as Germany and

in service-sector occupations such as financial services and medical diagnostics is much less demanding physically than manning an auto assembly line or mining for coal. Says Maria C. Robotham, manager of health care and aging studies at the Futures Group Inc., a consulting firm: "We are also finding more interest in second and third careers. A lot of retired people are returning to start a new career."

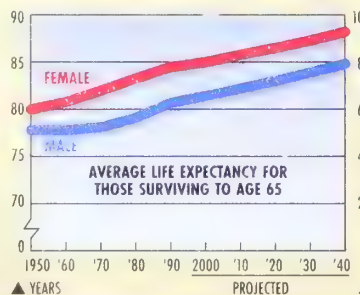
Of course, some people will find the

GROWING GRAY

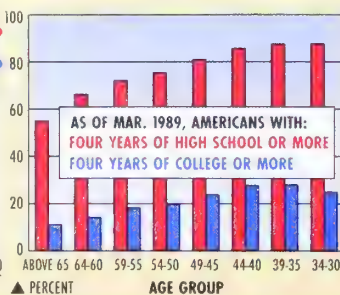
How the boomers will fare as they grow old

DATA: CENSUS BUREAU, STATISTICAL PORTRAIT OF THE U.S., CONGRESSIONAL BUDGET OFFICE, ROBERT AVERY AND MICHAEL RENDALL, FEDERAL RESERVE BANK OF KANSAS CITY, BW

ELDERLY AMERICANS WILL LIVE LONGER...



...AND BE BETTER EDUCATED...



...AS WELL AS HEALTHIER...



Americans have consumed like mad, living beyond their means, eager to whip out credit cards to buy the latest fashion or gadget. The personal savings rate has fallen from an average of some 7% in the 1960s through 1980s to the 4.5% range in the 1990s. The Merrill Lynch Baby Boom Retirement Index estimates that baby-boom households save at just one-third the rate needed to provide them with a secure retirement at age 65. "We think there's a very large problem, and it's going to get worse," says John L. Steffens, executive vice-president for Private Client at Merrill Lynch & Co.

Yet the personal savings rate understates the country's financial well-being. Boomers are entering their peak income years, when people traditionally begin to save more. "We are at a secular and cyclical low in the personal savings rate, and we should see it rise throughout the rest of the decade," says Mark M. Zandi, economist at Regional Financial Associates Inc. "Ten years from now, we'll look back and say Wow!—did demographics have an impact on savings."

TESTED INTERESTS. Boomers already rack up surprisingly well compared with their parents. The average baby boomer had a real 57% after-tax income advantage over his or her parents, after adjusting for variations in household size and composition, calculate economists Richard A. Easterlin of the University of Southern California, Diane J. Acunovich of Williams College, and Christine M. Schaeffer, sociologist at USC. Key to the boomers' strong material gains are women working and smaller families. "The baby boomers have been able to achieve material economic gains, on average, through a lot of family sacrifices," says Easterlin.

But will retirees be able to maintain their preretirement living standards

rather than simply do better than their parents financially? Here the evidence is more controversial. To some, the answer hinges on whether retirees are willing to sell their homes to help fund retirement living. For instance, the Merrill Lynch calculation—that boomers are saving at only one-third the rate necessary to maintain their level of consump-

aged buyouts and merger mania, companies cut back on their traditional, defined-benefit plans—a fixed payout based on a salary and years-of-service formula. Companies increasingly turned toward savings programs such as 401(k) plans—in which employees choose the investment option and bear all the investment risk. Young people in particular may not



TAKING CONTROL

Retirement savings are increasing, and more people are investing for the long term.

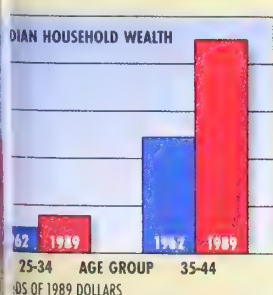
tion in retirement—discounts the home as a form of savings. The reason: Today's senior citizens are often reluctant to sell their homes, preferring to remain in their communities. Yet when Merrill takes housing wealth into account, boomers are saving at a full 84% of the rate needed to maintain current living standards, according to the Employee Benefits Research Institute.

The pension outlook is also raising concerns. In the 1980s, the era of lever-

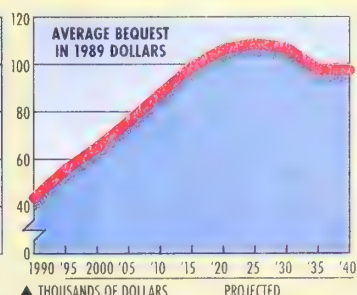
age taking sufficient advantage of these retirement savings plans. And with workers making their own investment decisions, poor or too conservative choices could lower retirement living standards (page 66).

Once again, the signs are improving. Both pension sponsorship and participation rates declined for a time in the 1980s. Yet since 1988, the proportion of workers vested in a pension plan, participation rates among workers, and the to-

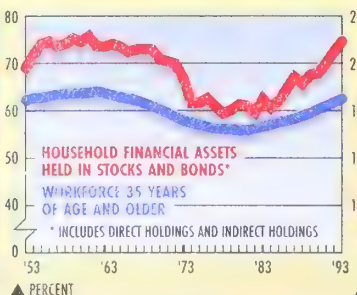
AND BETTER OFF FINANCIALLY...



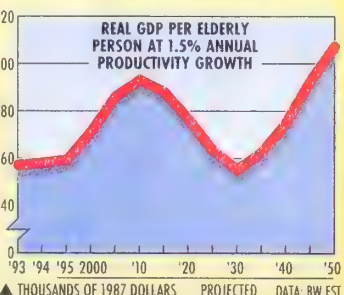
...GET MORE FROM THEIR PARENTS...

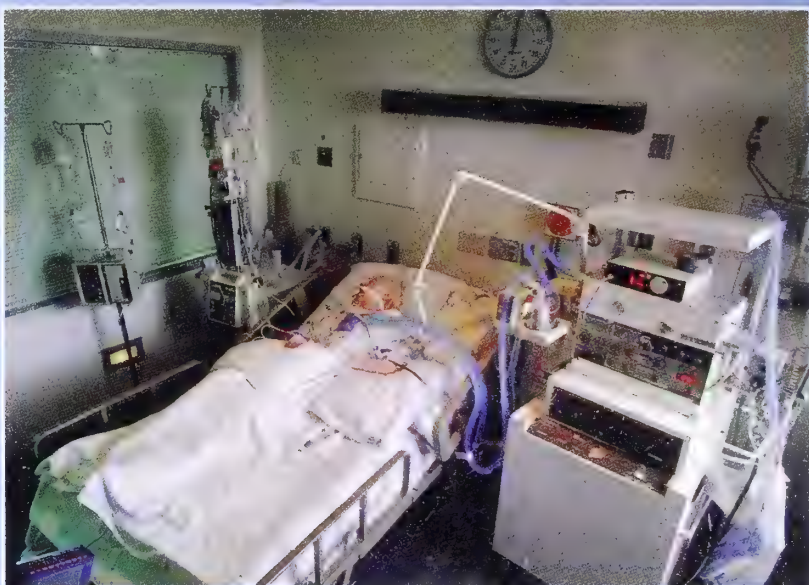
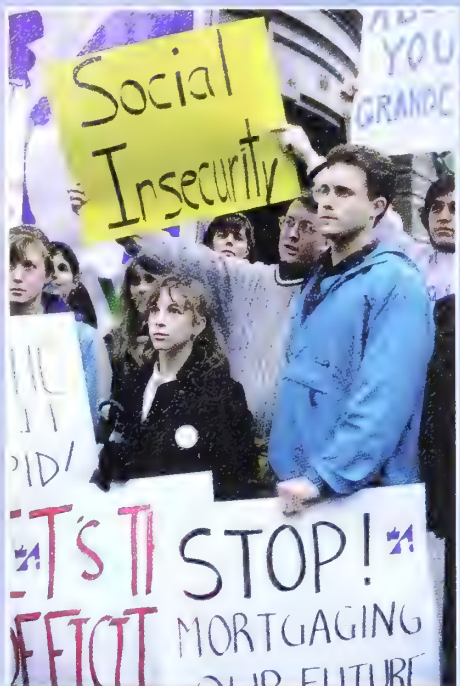


...OWN MORE STOCKS AND BONDS...



...AND NOT BE A BURDEN ON THE ECONOMY





◆ FUTURE TENSION?
The elderly aren't getting off the expense of the young

▲ SICK DAYS
Old folks need more care—but that isn't what's driving health inflation

tal number of workers employed where a plan was sponsored have all risen, according to the Employee Benefits Research Institute. In addition, the 56,651 net decrease in defined-benefit plans from 1985 to 1990 has been more than offset by a 149,078 net increase in defined-contribution plans—some of them at smaller companies that probably wouldn't have offered a retirement plan in the past. Even young people may be better off. Younger workers change jobs frequently and many fail to become vested in a traditional defined-benefit plan. By contrast, money that's put aside in a defined-contribution plan is "portable," and retirement savings can continue to grow even after switching employers.

WINDFALLS. And retirement savings are increasing. Contributions to 401(k) savings plans now total about \$490 billion and could top \$1 trillion by early 1999, according to Access Research, a consulting firm in Windsor, Conn. Easily funded through payroll deduction, 401(k) participation rates average 74% of those eligible. Contributions are often partially matched by employers, with more than half offering a 50% match. Although there is fierce disagreement among academics, economists such as James Poterba of Massachusetts Institute of Technology, Steven F. Venti of Dartmouth College, and David Wise of the Hoover Institution believe these tax-

advantaged contributions are not reducing savings elsewhere. "Our work suggests that future generations of retirees will have saved more than previous retirees," says Venti.

Indeed, an aging population is putting more money in long-term financial assets in the hope of earning higher returns. The share of household financial assets now held directly and indirectly in stocks and bonds is at 75%, the highest level since 1961, according to Donald P. Morgan, a senior economist at the Federal Reserve Bank of Kansas City. "Walk into any large bookstore in America and look at the personal finance section. They're not just for rich folks anymore, as most big publishing houses add 10 to 20 titles a year in this area," says Neal Cutler, director of the Boettner Institute for Financial Gerontology at the University of Pennsylvania.

Even the elderly often save well into their 80s, say economists. Take Francis Johnston, 81, of New Hope, a suburb of Minneapolis. Johnston, who retired in 1982 as a linotype operator for a religious publishing company, saves about \$10,000 a year. The way he saves is to avoid spending the interest on his CDs and bonds. At the end of every year, whatever amount of money is left over from pension or Social Security checks is put into a CD or annuity.

Bequests are expected to boost savings in coming decades. Boomers will inherit some \$10.4 trillion from 1990 to 2040—for a mean inheritance of some \$90,000, according to Robert B. Avery and Michael S. Rendall, professors of consumer economics and housing at Cornell University. Take Laura Weston, 36-year-old stage manager for the Sacramento Theatre Co. She inherited "quite a bit of money"—something over \$100,000. Today, she's building her savings by contributing to an individual retirement account, investing in equity mutual funds, and touching her inheritance as little as possible.

COUNTERBALANCES. Of course, not everyone is able to put money aside or will be better off in retirement. Inheritances are highly skewed toward the wealthy. Many families will feel squeezed between paying for their children's education and caring for elderly parents. More disturbing, median incomes of households headed by someone aged 25 to 34 with less than a high school diploma fell by 13% from 1962 to 1989. These same households have little wealth, too. "There is a group of people living close to the edge from paycheck to paycheck," says Diane Swonk, economist at First Chicago Corp.

Social Security will alleviate some of the economic pressure on those with fewer resources to draw upon in retirement. In 1994, Social Security replaced about 42.5% of average earnings of those who retired at age 65, but for low-wage recipients the replacement ratio was about

Productivity gains should boost the elderly's share of the pie

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57.5%. Under the Social Security Administration's midrange assumptions, similar replacement ratios are likely to hold for baby boomers who retire in 2030 at the then normal retirement age of 67.

True, trouble looms in 2013. That's when the Social Security system will begin paying out more in benefits than it receives in tax revenue. Although it may be political dynamite to tamper with Social Security, a number of economists agree that Social Security's financing problems are manageable with a combination of phased-in tax increases and

benefit cuts, such as making cost-of-living adjustments less generous and raising the retirement age to 69 or even 70 years old. "You don't have to do anything draconian," says Bruce D. Schobel, a vice-president at New York Life Insurance Co. and staff actuary on the 1983 Greenspan Social Security Commission. And higher productivity will also ease pressure on the Social Security system.

Today's huge immigrant wave will also help meet those Social Security checks. More than 1 million newcomers a year have arrived in this country in the past

decade. Immigrants tend to be in the prime of their working lives with decades of taxpaying work ahead of them. "An influx of immigrants keeps the labor force younger, and that is an important offset to the aging effect," says Edward Wool economist at New York University.

At the same time, advances in medical technology—from beta blocker reducing hypertension to hip replacements—are making it easier for the elderly to live active lives. Americans are smoking less, exercising more, and are better educated than their parents. Say

INVESTORS NEEDN'T FEAR THE MARCH OF TIME

Remember *Limits to Growth*, the 1970s jeremiad by Donella and Dennis Meadows? Their computer model predicted catastrophic shortages of oil, food, and other commodities if economic and population growth remained unchecked. Now, oil prices are lower than they were in 1974, adjusted for inflation, and commodities are plentiful and cheap worldwide.

Today, the popular polemic would be *Malthus Visits Wall Street*. Simply put, there are too many baby boomers, and when elderly, they will overtax the economy's resources. Real home prices will fall in coming decades with hordes of elderly home sellers and not enough young home buyers. When they retire and draw down their private pensions, the massive asset sale will depress stock and bond values, leaving boomers with less money in their golden years.

Yet investors shouldn't fear the march of time. The longer investment horizons are, the easier it is to ride out the swings of the business cycle.

NEW DEMAND. Over the past several years, home prices in some markets did plunge, and a lot of upscale houses went unsold. Yet overall, housing is still an appreciating asset, and real home prices are up. From 1850 to 1992, real estate's after-inflation return was 2.5% a year, a figure based on a study of 16,000 unencumbered land sales in Middlesex County, Mass., says Karl E. Case, economics professor at Wellesley College. Immigrants, who are flocking to the U.S., will be a source of new home-buying demand, adds Anthony Downs, real estate economist at the Brookings Institution. And on the supply side, homebuilders will cut back on projects if demand slackens.

The specter of a pension-asset implosion is implausible, too, largely because of the move toward market economies around the world. The spread of private property rights and openness to the world economy is encouraging vast amounts of capital to flow across borders. By the time boomers need to sell, markets will be far more international. Says Jeremy J. Siegel, financial economist at the Wharton School: "There will be a lot of foreigners to buy U.S. assets in the 21st century."

The outlook for long-term investors

Bonds should also retain value, and fierce domestic and global competition should keep inflation at bay. The bond-market vigilantes—and their public representatives, central bankers—will make sure rates surge at even a hint of inflation. And bonds do well when inflation is constrained. In the last third of the 19th century, with negligible inflation, bonds had a total real return of 6.57% a year (and stocks, 8.5%). By contrast, from 1966 to 1981, when consumer-price inflation averaged 7%, bonds had a total return of -4.2% (and stocks -0.4%).

STRIKING A BALANCE. The most critical decision to be made by anyone saving through a 401(k), individual retirement account, or other such plan is to participate. The next decision is the balance among stocks, bonds, real estate, and other assets. Many people are too conservative in their investment choices, unwilling to put their nest egg at risk to the swings of the stock market. Most economists agree that young people should allocate as much as 80% to stocks and no less than 50%. Older investors typically invest 50% or less in stocks. Yet with average life

expectancy of about 17 years after age 65, stocks still have a place in an investment portfolio even after retirement.

What investors really have to fear is not the inevitable swings in the markets but that policymakers will change the rules of the game on them. Over the past decade, government policymakers have steadily limited the tax advantaged preferences in employer sponsored pensions and IRAs to trim back the federal budget deficit. Despite all the fearmongering on Wall Street the underlying message is right: People need to save more to protect themselves from political meddling.

By Christopher Farrell in New York

IN THE LONG HAUL, INVESTING BEATS INFLATION—EASILY

ANNUAL MARKET TOTAL RETURNS ADJUSTED FOR INFLATION

INVESTMENT	1802–1992
STOCKS	6.7%
GOVERNMENT BONDS	3.4%
GOVERNMENT BILLS	2.9%
CONSUMER INFLATION	1.3%

DATA: PROFESSOR JEREMY J. SIEGEL AT THE WHARTON SCHOOL

appears appealing, especially for equity investors. Stocks are both a safer asset than bonds and a higher-return investment for periods longer than a decade. From 1802 to 1992, U.S. stocks had an average real return of 6.7% a year vs. 3.4% for bonds, according to Wharton's Siegel. Higher U.S. productivity and world-class technological innovation give the U.S. every chance of regaining global industrial leadership. And less-developed nations joining the free-market world give the global economy an unprecedented degree of diversity, which means a less risky world economy, says Peter L. Bernstein, a New York-based economic consultant.



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LEAD FROM STRENGTH.

Cover Story

Dennis W. Jahnigen, director for the Center on Aging at the University of Colorado Health Sciences Center: "The economic impacts of living better lives are very positive—as opposed to 20 years ago when people had stroke after stroke before they died." Adds Maria Robotham of the Futures Group: "There are changes in behavior patterns that

care to the elderly is the only way to contain costs.

For instance, many analysts believe the U.S. spends far too much on expensive and largely futile medical treatments on the aged. Yet in 1988, the amount that might have been saved by reducing the use of aggressive life-sustaining interventions and care for dying patients of

Instead of a burden, senior citizens may indeed be tomorrow's economic bonanza. Certainly, financial services of all kinds, from mutual funds to estate planning, is a growth market. The senior citizen market is more than candelabras and "Pampers and nursing homes," says Eric Pfeiffer, director of the Suncoast Gerontology Center at the University of South Florida Health Sciences Center. "The elderly are still an untapped market in housing, clothing, tours, and investment advice," he adds.

Until recently, a nursing home was one of the few alternatives for those who were finding it difficult to manage their own households. In the past decade, however, "assisted" living centers for those who need some help have been gaining in popularity. At the moment, many are quite expensive, although competition should bring prices down over time. The Heritage Club in Denver has both independent apartments and assisted living, and some of the homes also have nursing facilities. Jean A. Carson, 88, moved into her two-bedroom apartment three years ago. She fixes her own breakfast and lunch but eats dinner in the dining room downstairs. She works to stay healthy at exercise class and in the weight room. "I'm better than I was 10 years



WHY ECONOMIC LIFE? Because seniors are living longer and more active lives, they need more services.

could keep people productive longer in economic terms."

Yet in the country with the biggest medical tab in the industrial world, won't the elderly send health-care inflation into the stratosphere? The elderly now consume more than a third of all health care in the U.S., and an aging population suggests that proportion will grow over time—old folks need more medical care. Says Richard D. Lamm, former governor of Colorado and now director of the Center for Public Policy & Contemporary Issues at the University of Denver: "What do you do with an 87-year-old with Alzheimer's who needs a hip replacement?"

TICKTOCK. There are no easy answers. Physical afflictions, such as hearing loss and frailty, increase with the ticking clock of age. And as more people move into their 80s and beyond, mind-robbing diseases such as Alzheimer's mean more expensive nursing-home care. But that isn't the same as saying an aging population is the driving force behind health-care inflation or that rationing health

care at all ages was 3.3% of total health-care expenditures and 6.1% of Medicare costs, estimate Dr. Ezekiel J. Emmanuel, assistant professor at the Harvard Medical School and Linda L. Emmanuel, assistant director of the school's medical ethics unit. In other words, out of that year's \$546 billion medical bill, the cost savings would have amounted to only \$18.1 billion and \$5.4 billion, respectively.

"Health-care costs are growing out of control, and the aged are high-end users of medical care, but to say that the increase in costs is attributed to aging is wrong," says Daniel Mendelson, researcher at the health-care consulting firm Lewin-VHI.

Indeed, the primary force pushing health costs ever higher in the U.S. is technology, not demographics. And most of the growth in health-care spending resulting from scientific and technological medical advances are applied to the general population, not just the elderly, says Dr. William Schwartz, professor of medicine at the University of Southern California.

he senior citizen
market may be
an economic bonanza

ago. I've got muscles and joints I haven't used for years that are working again," she says.

HELPING HANDS. Colleges see senior citizens as a market opportunity, too. The Academy of Senior Professionals at Eckerd College (ASPEC) in St. Petersburg, Fla., brings retired professionals together with Eckerd's undergraduate student body as teachers and participants in classes. "It's very important for older people to pass on values and experiences in the hope these things will be helpful to tomorrow's leaders," says Arthur L. Peterson, director of the program.

The age wave is sure to bring about plenty of upheaval. The aging of America isn't a story about the imminent, even distant, arrival of utopia. But there are many positive fundamental forces at work. The nation is more productive than at any time since the 1960s. The elderly are more vital than before. Americans can afford to grow old. And they will grow old gracefully.

By Christopher Farrell in New York, with Ann Therese Palmer in Chicago, Sandra Atchison in Denver, and Bob Andelman in St. Petersburg, Fla.

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CLINTON COZIES UP TO BUSINESS

Corporate gifts to the DNC have reached unprecedented levels

He campaigned as a Southern populist who railed against corporate greed and business as usual in Washington. But guess who's been coming to dinner—and lunch and breakfast—since Bill Clinton moved into 1600 Pennsylvania Avenue? After years of hobnobbing with Republican Presidents, blue-chip CEOs are discovering that they can do brisk business with a Democratic Chief Executive, too.

Finance Director Terence R. McAuliffe.

Why the corporate largesse? Some execs covet an ambassadorship or a ticket to a glitzy event. Others seek insurance to protect themselves from regulatory assault. "I tell my clients that if they want to get in the door they need to pay up," explains a plugged-in Democratic lobbyist.

To traditional Democrats and ethics crusaders, wooing of business amounts

was governor of dirt-poor Arkansas, he has courted business with tax breaks and regulatory relief. As President, he has even more goodies to bestow.

Clinton lunches at least once a month with CEOs. And he often phones executives, such as Xerox Corp.'s Paul A. Allaire, a donor and longtime Democrat, about his economic message. White House aide Alexis M. Herman says she feels she can "pick up the phone anytime and call" Procter & Gamble Co.'s Edwin L. Artzt to talk trade. Clinton, says Artzt, "maintains an excellent dialogue with business leaders."

One highly coveted corporate prize is a seat on Commerce Secretary Ronald H. Brown's trade missions. On Aug. 2, two dozen execs—including DNC donor Lodwick M. Cook of Arco, Raymond W. Smith of Bell Atlantic, Edwin Lubberger of Entergy, and Bernard I. Schwartz of Loral—flew with Brown to China and Hong Kong. The trip already has paid off. Entergy, Westinghouse

HEY, BIG SPENDERS

Corporate America is filling the coffers of the Democratic National Committee, and many of these companies have big stakes in White House decisions. Here's what some of the biggest companies and their top executives gave from July, 1992, to June, 1994.

DATA: COMMON CAUSE, BW

With an outreach campaign that transcends anything the Democrats attempted before, the Administration has gone to enormous lengths to cultivate a wary business community. Despite the fact that the President devoted his first year to deficit reduction and expanded trade, he still isn't making many business converts. But he's definitely winning some corporate wallets. Since Clinton took office, unprecedented levels of cash from Corporate America have poured into the Democratic National Committee. The Democrats have raised a record \$60 million—the bulk of it from big donors. The party's Business Leadership Forum, which has an admission price of \$10,000, has ballooned from 135 members last year to 850 now. "People are screaming to give us checks," crows DNC

to mutual back-scratching that's ripe for abuse. That's really true, they say, with an Administration pursuing an industrial policy to promote some industries. Says Fred Wertheimer, president of Common Cause: "All this literally puts the Presidency on the auction block."

HAPPY CAMPERS. Case in point: Boeing Co. From 1991 through 1993, the company had donated \$16,000 to the DNC. But since Feb. 28, 1994, Federal Election Commission reports say, Boeing has given \$65,000 to the party. The gifts began days after Clinton announced that Saudi Arabia had agreed to buy \$3.6 billion worth of commercial aircraft from Boeing. Boeing says the gifts were not tied to the Saudi deal.

Veteran Clinton-watchers are not surprised at his probusiness bent. Since he

BABY BELLS



Lobbying hard for approval to break into long distance



\$447,740

ARCHER DANIELS MIDLAND

Won White House backing for proposal requiring corn-based ethanol in gasoline



\$402,500

Electric, Pitney Bowes, and IBM announced contracts with the Chinese.

Business seems particularly pleased with Brown's supersalesmanship—much so that the Commerce Dept. keeps a "Happy CEO" file with letters of thanks for the government's help. "I could not ask for a better advocate for the U.S. business community," Occidental Petroleum Corp. CEO Ray R. Irani wrote last April after returning from a trade mission to Russia. Occidental has donated \$152,549 to the DNC since July, 1992.

The Democrats are happy, too. Largely because of corporate gifts, the party has virtually closed the fund-raising gap with the GOP. The Republican National Committee has raised \$66 million since January, 1993, but three-quarters came from small donors.

The Dems' fat-cat dependency has riled critics, who cry hypocrisy. During the Bush Administration, Clinton charged that "cliques of \$100,000 donors buy access." Now, some of these same GOP benefactors have become switch-hitters, among them Arco's Cook, Dwayne Andreas of Archer Daniels Midland, Carl Lindner of American Financial, and Martin Davis, president of Davis Cos.

No wonder Clinton has stopped complaining that U.S. political leaders "are being held hostage by big-money interests." He's now spending his summer vacation golfing with super-investor Warren E. Buffett and dining with William H. Gates III, CEO of Microsoft. And Clinton rakes in millions at black-tie fundraisers. Co-chairs of a June 22 Washington Presidential gala—where execs paid up to \$100,000—included ADM's Andreas and Ronald O. Perelman of Revlon Inc., who gave the RNC and the DNC each \$100,000 during the 1988 campaign. Two weeks later, ADM got a boost when the Environmental Protection Agency issued a rule requiring use of corn-based ethanol in gasoline.

of Staff Thomas F. McLarty III. Middleton is always taking calls, helping executives find the right Administration person to solve a problem. McLarty, now a Presidential counselor, devotes up to half his time to troubleshooting for business.

Clintonites, of course, deny any quid pro quos, insisting that they're only helping business create jobs for Americans. Likewise, contributors profess only good intentions. Loral's Schwartz, who wrote the DNC a \$100,000 check in June, says he's a lifelong Democrat. Schwartz adds that he doesn't need to buy access: "I can open any door I want as chairman of a \$6 billion company."

But not all executives are so confident that the White House is an equal-opportunity listener. Remarks one senior Clinton adviser: "Someone who doesn't give doesn't get the same chance to make his case." Adds a Democratic lobbyist: "If an official sees you at a fundraiser, you'll be perceived as having clout. When it comes time to make your case, you will be respected or feared."

From business' standpoint, political

civic-minded. Consider Walt Disney Co., which gave the DNC \$250,000 since mid-1992 and lobbies on many issues. Now it must overcome federal environmental hurdles for a theme park in Virginia. When Disney's *The Lion King* premiered at a Washington theater in June, who sat next to Disney Chairman Michael D. Eisner? Environmental czar Al Gore. **HOLLYWOOD HUSTLE.** Arco is another corporate donor angling for favorable treatment. At a White House lunch for execs in June last year, Clinton surprised Arco Chairman Cook with a birthday cake. As he blew out the candles, Cook may have wished that the White House would lift a 21-year ban on exporting oil from Alaska, where his company has major interests. Clinton is considering that idea.

To be fair, the White House also talks to executives who haven't given the Democrats a dime. And donations don't guarantee special treatment. Take the entertainment industry, which has given Democrats \$1.7 million since 1992. During last year's negotiations on a new General Agreement on Tariffs & Trade,

WALT DISNEY

Wants federal agencies to agree that Disney's theme park in Virginia won't violate environment laws

\$250,000



ARCO



Would like Administration to push for lifting export ban on Alaskan oil

\$201,500



TIME WARNER

\$518,333

BENEFICIAL

\$406,000

MCA

\$250,000

SEAGRAM & SONS

\$232,704

ANHEUSER-BUSCH

\$186,000

SONY

\$181,650

REVLON

\$171,000

WASTE MGMT.

\$161,000

ERNST & YOUNG

\$160,300

OCCIDENTAL

\$152,514

MCI

\$115,000

A sure sign that the Clintonites appreciate the link between business dialogue and dollars is the fact that so many top Administration officials, such as Robert E. Rubin, former co-chairman of oldman, Sachs & Co., collected millions from Wall Street before being named director of the White House National Economic Council. Kenneth D. Brody, another Goldman Sachs fundraiser, now heads the Export-Import Bank.

GOOD INTENTIONS. White House aide Sherman, Brown's deputy at the DNC, now drums up corporate support for Clinton. Melissa Moss, a former DNC finance director, helps pick CEOs for Commerce trade missions. Mark Middleton raised campaign money before becoming an aide to former White House Chief

giving is a small expense that can reap big gains. That seems to be the case for AT&T. When Clinton's Inaugural Committee turned to business to help finance its January, 1993, extravaganza, the company came through with a \$100,000 loan, fax machines, and telephone gear. Within two weeks, Commerce chief Brown began lobbying Saudi Arabia to hire AT&T for a phone modernization project. Last spring, the Saudis awarded the \$4 billion contract to AT&T over foreign competitors. Soon after, DNC records show, the company sent the party \$20,000. AT&T says it's a regular contributor to both parties and there is no tie-in between the contract and its donations.

But companies with big stakes in government decisions aren't merely being

Hollywood lobbied ardently for the U.S. to insist that the French ease import limits on U.S.-made films and videos. At a \$50,000-a-plate fund-raiser at the Los Angeles home of billionaire Marvin Davis last December, studio heads pressed Clinton on the issue. The White House did push the moguls' cause, but when the dispute threatened to scuttle GATT, Clinton caved.

All this fraternizing between Clinton and the fat cats proves that even a reformist Democrat can't resist the lure of bright lights and big money. That, more than anything else, may explain why the vacationing President is relaxing with the rich and famous on the Vineyard—rather than sinking into the mineral baths of Hot Springs.

By Susan B. Garland in Washington

SLOW BOIL FOR ABB IN THE U.S.

A new boss is turning up the heat to power a turnaround



POWER ENGINEER DONOVAN: JUST WHAT ABB NEEDS IN AMERICA?

While scouting the U.S. for acquisitions in the late 1980s, ABB Chief Executive Officer Percy Barnevik couldn't help noticing the 30- to 40-year-old boilers still in service at many American electric utilities. It seemed to be a rare opportunity for the newly formed Swiss-Swedish ABB Asea Brown Boveri (Holding) Ltd., the result of a merger of two European engineering companies, to build up its small U.S. beachhead. Barnevik went on a spending spree, paying more than \$2.3 billion in 1989 for Combustion Engineering Inc. and Westinghouse Electric Corp.'s smaller electrical-transmission-equipment unit. He aimed to have a one-stop shop ready to do business once the utilities started buying again.

Five years later, those utilities have even older boilers. Stymied by rising energy conservation, restructuring in the U.S. power industry, and the unwillingness of state regulators to allow massive new construction programs, the capital-spending boom never materialized. Instead, money-losing Combustion Engineering has proved a much tougher turnaround than Barnevik expected. Since 1989, ABB has shed some \$700 million in businesses that were part of the two acquisitions, and employment has fallen from about 40,000 to 25,000. From a high of \$7 billion in 1989,

U.S. revenues declined to \$5.6 billion in 1993, or 19% of ABB's worldwide revenues of \$30 billion.

Now, Barnevik is reworking his U.S. turnaround strategy. With new management in place, he is pushing exports to strengthening global market and cranking up sales of industrial and transportation equipment. He is clearly counting on better performance. Although ABB does not release results for individual businesses, profits in the U.S. still suffer from the overhang of debt used to finance the expansion. "The U.S. results are decent," says Barnevik, "but they are still below the group standard and need improvement. I'm impatient. I would like to see faster progress."

FAR CRY. Worldwide, ABB's bottom line is looking better as a result of the \$2 billion-plus it has spent on restructuring in the past five years. Net income for the first six months of 1994 rose 31%, to \$322 million. Although revenues were roughly flat, at \$13.1 billion, for the period, new orders showed an uptick of 3%.

But Barnevik's impatience shows

the objective he has set for managers: a 10% return on sales. In the U.S., reaching that goal is the job of Robert J. Donovan, who took over as head of ABB's American operation earlier this year, after a one-year stint running its U.S. power-plant business. He's a far cry from his predecessor, German-born Gerhard Schulmeyer. For starters, the 41-year-old Donovan is American—and a West Point graduate to boot. A nuclear engineer, he's a veteran of the power business, having joined ABB in 1992 from Foster Wheeler Corp., a major boilermaker. Donovans also a plain-spoken fellow whose leisure pursuits include hunting, fishing—and in earlier days, beekeeping. In fact, Donovan has written

ABB'S AMERICAN JOURNEY

SPENDS \$2.3 billion in 1989 to acquire boilermaker Combustion Engineering and Westinghouse's electrical-transmission and distribution business

SELLS off \$700 million in assets and pares payroll from 40,000 to 25,000 over a five-year period through layoffs, transfers, and divestitures

SHIFTS sales push for steam turbines and boilers from U.S. to emerging markets and marries European technology with U.S. manufacturing to launch a new line of highly efficient gas turbines

DATA BUSINESS WEEK

ten two books on the outdoors.

That's quite a change from Schulmeyer, a former Motorola Inc. executive who concedes he is more at home with computers than boilers. Schulmeyer had returned to Germany to head Siemens' computer subsidiary, Siemens-Nixdorf Information Systems. "I wanted to run a company on my own," he says.

Donovan may be just what ABB's North American operation needs. The company, based in Stamford, Conn., relies on the clubby yet fiercely competitive power market for two-thirds of its annual revenues; the rest comes from robotics, environmental controls, and rail construction. "It is an industry that places a lot of weight on personal relationships," says Donovan. "I've kind of grown up in the business."

With sales in the U.S. still spotty, the real mother lode for ABB's North American operations may prove to be the export market. When ABB bought Westinghouse and Westinghouse, total exports for the combined companies represented no more than 12% of sales. Today, that percentage has more than doubled, and the goal is to raise it to at least one-third of total U.S. sales.

HEAVY LIFTING. In the world market, ABB is battling the likes of General Electric, Westinghouse, Siemens, and Mitsubishi for orders from Asia and other rapidly developing areas. But some industry observers believe ABB's strengths in boilers and turbines and its range of technologies could prove unbeatable in such markets as the current bid by ABB's U.S.-based nuclear unit for a \$2 billion contract to build a 1,350-megawatt power plant in Taiwan. In the past two years, ABB has snagged important contracts worth more than \$500 million in China and South Korea.

Right now, ABB's nonutility businesses are doing the heavy lifting. Surging U.S. production has created record demand for industrial robots and paint-finishing equipment, while rising housing starts have boosted the electrical-transmission business.

ABB is also starting to make some headway in the long-sluggish U.S. rail market. Last year, it won a \$285 million contract for commuter cars in the Philadelphia area. And ABB is leading a consortium that includes GE and Raytheon to bid on a \$400 million contract to build high-speed Amtrak trains for the Washington-Boston route.

There are even some bright spots for ABB in the moribund U.S. electric-utility industry. A new gas turbine, designed in part by ABB's European researchers, built in the U.S., won a pioneering order last September from Jersey Central Power & Light Co.

Overall, Barnevik now has his North American operations close to the position he envisioned back in 1989. Reaching his goal has cost him and his company a lot of money, but his dream of building a global electrical-engineering powerhouse by marrying European and American technology is finally taking shape.

by Tim Smart in Stamford, Conn., and Gail Edmondson in Paris

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SPIEGEL'S BOOK IS A REAL PAGE-TURNER

Its catalog business and Eddie Bauer chain are flourishing

When retailer Eddie Bauer Inc. opened a store in Wichita in July, shoppers snapped up 250 men's flannel shirts in three weeks, wiping out the inventory. With temperatures hitting the 90s, it sure wasn't the weather. Besides, the same August craze for flannel has pummeled inventory in Eddie Bauer stores from New York to San Francisco.

Why the rush? Flannel is hot for back-to-school dressing—almost as hot as Eddie Bauer itself. Says Alexander P. Paris, retail analyst at Barrington Associates: "They've got a lot of momentum."

The same could be said for Spiegel Inc., the Chicago-based clothing merchandiser that bought Eddie Bauer in 1988. Fueled by expansion at the popular outdoor-clothing chain, which now accounts for 47% of Spiegel's sales, and a revival in its mainstay catalog business, Chief Executive John J. Shea has transformed Spiegel into one of the fastest-growing players in the retail landscape.

NEW DATA. While one-time rivals such as Montgomery Ward & Co. and J.C. Penney Co. phased out their general-interest catalogs, Shea revamped Spiegel's 600-page catalog—and its sales are up 30% this year. Spiegel's \$40 million purchase of New York Inc., a catalog company aimed at middle-income women, and new product launches such as E Style, a catalog for African-American women, have also spurred revival. And in a bid to gain a

foothold in the potentially lucrative market for on-line shopping, Spiegel has launched an experimental cable-TV channel. "Wherever the consumer wants to be, that's where we'll be," says Shea. "If we're not printing catalogs in 10 years, we'll still be here."

Although many hot retailers have stumbled over too-rapid expansion, so far Shea's strategy appears to be

CEO SHEA: EXPANDING THE BAUER CHAIN AND DEVELOPING A CABLE-TV SHOPPING CHANNEL

working. Net earnings before nonrecurring charges jumped 49%, to \$70.4 million in 1993, while revenue rose 17%, to \$2.6 billion. Analyst Dean Ramos of Minneapolis-based broker Dain Bosworth Inc. estimates earnings will rise 26%, to \$88.6 million, for 1994, on revenue growth of 23%, to \$3.2 billion.

That's a long way from the company Shea took over back in 1981, when the floundering merchandiser was acquired by Germany's Otto-Versand, Europe's biggest catalog merchandiser. Otto-Versand's backing enabled Spiegel to invest in state-of-the-art computer and distribution systems. Just as important, the German giant shared its sophisticated market-research methods. Armed with new data, Shea saw a niche in creating the first apparel catalog targeted at upscale

working women and made the once dowdy general catalog.

By the late 1980s, revenues had tripled. Spiegel sold scads of \$495 wool blazers to working women too busy to shop. But Spiegel stumbled during the 1990-91 recession. Forced to fold its \$33 million a year scale Honeybee Inc. catalog and stores, Spiegel's profits plunged from \$73.3 million in 1989 to \$16.9 million in 1991.

TV LINK. But as the recession ended, Shea seized on another change in women's buying habits. "Value became an important equation. The consumer went from Gucci to the Gap," Shea says. Spiegel scaled back pricey things and began discounting hundreds of "Best Bet" items.

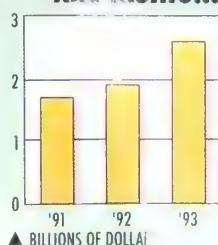
But Shea's smartest move may have been the 1988 buy of Eddie Bauer, a Seattle-based retailer of casual clothing, from General Motors Inc. Eddie Bauer mail-order and retail sales have since quadrupled, to \$1 billion, spurred by the trend toward casual work togs and popular TV shows such as *Northern Exposure* featuring its outdoorsy look.

The value philosophy was also applied to Eddie Bauer, where te

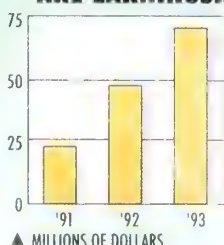


SPIEGEL: ON A ROLL

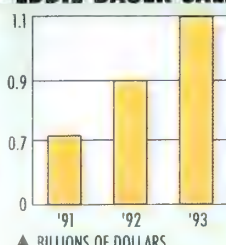
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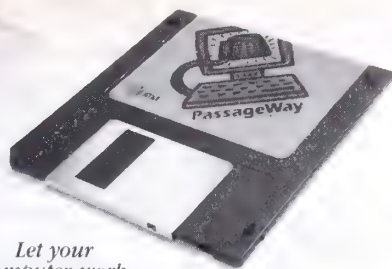
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price of all denim jeans was permanently lowered to \$30 in 1991. As a result, jeans sales quintupled, to 2.5 million pairs, in 1992. Last year, Eddie Bauer's same-store sales averaged 11% growth while many retailers struggled to achieve low single digits. "We're obviously gaining market share," says Eddie Bauer President Richard Fersch.

That success has allowed Eddie Bauer to expand quickly. Sixty new stores will open this year and 75 in 1995, bringing the total to 430, up from 58 in 1988. Eddie Bauer is also launching its catalog and opening three stores in Japan this fall and, with backing from Otto, will expand its catalog to Germany.

STRETCHED? Still, analysts question whether Eddie Bauer is growing too fast. Although store expansion has been financed by cash flow, management resources could be stretched thin. Dain Bosworth analyst Ramos also worries that Eddie Bauer's narrow focus will make it vulnerable to changes in style. But Fersch dismisses such concerns: "We think we have a balance sheet that will support our growth and the management expertise to handle it." Bauer's customers average 30 to 50 years old, making them less likely to chase fads.

Shea will have his hands full developing Catalog 1, an upscale cable-TV channel. The Spiegel/Time Warner Entertainment Co. joint venture began in March, featuring merchandise from Spiegel, Crate & Barrel, Williams Sonoma, and the Sharper Image, among others.

Shea has tried to position Catalog 1 far from the downscale slot occupied by QVC Network Inc. and the Home Shopping Network Inc., where cubic zirconia rings and thigh toners are hawked in a game-show atmosphere. Catalog 1 stars highly polished women "anchors" who discuss fashion and decorating. One show features Crate & Barrel Stores Chairman Gordon I. Segal presenting wine glasses and wrought-iron bed frames.

But the sophisticated approach has not worked. Industry sources say sales in the first six months have been tiny and the station is being extensively revamped. In October, the program's anchors will disappear. The pace will be quicker, with twice as much merchandise shown. Yet there's little evidence that the wealthy actually want to shop by TV. Q2, an upscale channel rolled out in June by QVC, is also off to a bad start. Shea admits it may take years to find the correct formula, but he insists that Spiegel must position itself now. "It's the future," he says. "Why wait?" Given his track record sniffing out retail trends a step ahead of the crowd, don't bet your cubic zirconia against it.

By Susan Chandler in Chicago, with bureau reports

Science & Technology

MEDICAL TECHNOLOGY

BREAK A LEG—AND BIO CERAMICS MAY MEND IT

These new materials could grab a chunk of a \$2 billion market

Back in 1967, a young ceramics engineer named Larry L. Hench was designing semiconductor switches for nuclear weapons. His career took a turn on a bus ride to an Army materials conference. A colonel just back from Vietnam told Hench that thousands of soldiers were having limbs amputated because of faulty implants. "Those damn metals and plastics are rejected," Hench recalls him saying. "Why don't young guys like you do something to help people instead of learning how to blow them up better?"

Inspired, the University of Florida scientist decided to try. He began work under a grant from the U.S. Army in September, 1969, and two months later came up with a glass that bonded so well to bones and tissues of rats that experimenters couldn't dislodge it. On analysis, it appeared that Hench's glass was a magnet for bone cells (illustration). In 1985, after lengthy development and testing, the Food & Drug Administration approved the petition of U.S. Biomaterials Corp. in Baltimore, to use Bioglass, as it's now called, to replace the bones of the middle ear to restore hearing. It has since been approved for patching facial bones and repairing diseased gum tissue.

What Hench discovered in 1969 was among the first of a small but important class of medical materials: bioceramics. The category includes all kinds of glasses and ceramics that are implanted in the body. According to Medical Data International, a market-research firm in Irvine, Calif., sales of bioceramics should amount to only \$20 million this year in the U.S., the leading market. But the potential is much bigger: Americans spend \$2 billion a year on dental im-

plants, reconstructive devices such as hip and knee implants, and plates and pins for broken bones. Bioceramics could grab significant chunks of those markets. And they could capture smaller niches as well. For instance, bioceramics can be used to make artificial eyeballs that move in unison with real eyes.

As a sign of the mounting interest, the National Institutes of Health are including money for bioceramics next year as part of \$100 million in grants in the broader field of biomedical materials, which includes metals and plastics. Britain is funding similar programs. Several large Japanese companies are developing bioceramics, led by giant Kyocera, which has developed a ceramic hip ball replacement.

"PAUSE BUTTON." To be sure, hurdles remain. Getting FDA approval for a new medical device can take \$20 million and five years. That aside, it will take time to persuade surgeons and dentists to switch to bioceramics from well-known materials such as titanium alloys. Bioceramics can also be brittle. When used as coating on metal, they may flake off, causing inflammation. Curing those faults is expensive—and research dollars are scarce. "The health-care-reform environment has been like the pause button on a VCR for biomaterials," says Dr. Harold Alexander, director of the bioengineering department of New York's Hospital for Joint Diseases.

The good news for bioceramics can be summed up in one word: aging. With the population getting older and body parts wearing out, surgeons are performing nearly 500,000 bone grafts and 260,000 hip operations a year, Medical Data International says. Researchers at



MINERALIZED CORAL IS GOOD FOR BONE REPAIR BECAUSE TISSUE GROWS INTO IT, ANCHORING IMPLANTS

investigating a wide range of bone substitutes: metal parts with special porous coatings that bond with bone and issue; polymers derived from human amino acids; and, of course, bioceramics—ranging from ocean coral to glass fibers that the body absorbs.

Bone is particularly difficult for implants or grafts to emulate. It's a tough, resilient composite. Its main component, calcium-phosphorus compound called hydroxyapatite, gives it strength. Elastic strands of collagen give it flexibility. It is continually eaten away by its own cells—then rebuilt by new bone cells.

ORAL RELIEF. Declaring natural bone to be the gold standard, surgeons generally make grafts from bone harvested from a cadaver or skimmed from a patient's own hip, ribs, or skull. But natural bone has its own problems: Cadaver bone may suffer the same rejection as a transplanted organ would. Because it is living tissue, there's also a slight risk that cadaver bone can transmit diseases such as AIDS and hepatitis B. Harvesting a patient's own bone can be painful and may not yield enough material to mend a fracture. As for implants, metal doesn't always bond well with bone. Plus, metal's stiffness can shield surrounding bone from stress. In the absence of stress, the bone has a tendency to break down.

Thus, the search for something new. Among the most creative companies in the field is Interpore International in Irvine, Calif., which makes a bone substitute from coral, the lime-one exoskeleton of tiny sea animals called polyps. Interpore harvests unengendered corals from the South Pacific Indian Oceans and bakes them in a chemical bath to convert the limestone to hydroxyapatite: bone mineral. Three months after an implant, the structure is become filled with bone. Because it is brittle, Interpore's product is best for small patches and nonweight-bearing areas, such as the spongy ends of long bones.

Such mineralized coral is highly adaptable. Besides applying it to jaw and facial bones, Interpore is seeking FDA approval to use it for fusing vertebrae. Coral has also been fashioned into the shape of an artificial eye by San Diego's Degraded Orbital Implants, in a procedure patented by Arthur Perry, a San Diego surgeon. With eye muscles attached to a globe made of coral, the eye moves more naturally. Soon, nerve and blood vessels grow in, anchoring the implant.

Ideally, implants would go away once their work was done—eliminat-

A GLASS SCAFFOLD FOR BONE

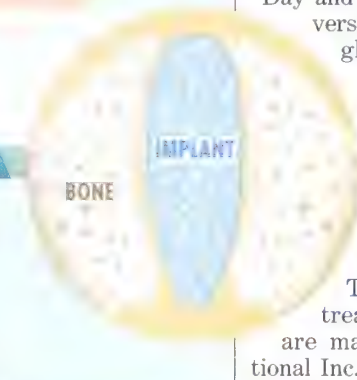
U.S. Biomaterials, a Baltimore-based company, makes a glass that provides a platform for new bone to replace lost bone in jaws, middle ears, and small fractures elsewhere in the body. Here's how it works:

START

Bioglass is placed in the defect, in this case, a jaw bone.

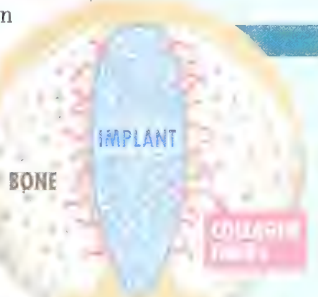
FIRST 30 MINUTES

Sodium in the glass reacts with blood and other body fluids, resulting in tiny, bone-like pores on the surface of the glass.



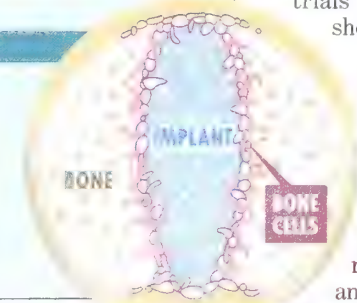
2 TO 24 HOURS

Calcium and phosphate ions from the glass and from body fluids form crystals of bone on the implant's microporous layer. Collagen fibers also bond to the surface.



6 HOURS TO 3 WEEKS

Bone cells grow among the collagen fibers, forming new bone. The bone fills in the spaces and locks the implant in place.



DATA: U.S. BIOMATERIALS CORP.

ing the surgery that's needed to retrieve metal parts, for instance. That's the point of work on resorbable composites of polymers reinforced with glass fibers, which could substitute for metal plates, rods, and pins. These materials could be entirely resorbed by the body in a year. Also, the materials transfer needed stress to bone better than metal does, so the bone doesn't dissolve.

Glass and polymers are ideal partners for resorbables. In one effort, William C. LaCourse, a professor of glass science at Alfred University in Alfred, N.Y., is developing glass fibers to reinforce a resorbable polymer developed at Rutgers University. The polymer is made of the amino acid tyrosine and is

naturally broken down by the body. Alexander, of the Hospital for Joint Diseases, is coordinating the project under a \$2 million grant from Commerce's Advanced Technology Program. "When you consider the cost of the second surgical procedure [to remove the metal parts], we're saving about 40% of the total cost," Alexander says.

Glasses and ceramics have an almost unlimited number of uses. Delbert E. Day and Gary J. Ehrhardt of the University of Missouri have developed glass spheres just a third the width of a human hair to deliver radiation to tough-to-reach liver cancer without damaging nearby organs. Tumors require a large blood flow, so the beads tend to be carried to them rather than to healthy tissue. The spheres are approved to treat liver cancer in Canada and are marketed by Nordion International Inc. in Kanata, Ont.

PLAY-DOH. Many medical researchers believe bioceramics may play their most valuable role as delivery vehicles for human growth factors, the stimulants for regeneration of bone and tissue. DePuy Inc. in Warsaw, Ind., has spent the past two years mixing a unique Play-Doh for surgeons with the help of Genentech Inc. This artificial bone graft combines a growth factor and tricalcium phosphate, a ceramic that releases the growth factor as it dissolves. Animal trials of the bone-graft substitute should be complete in 1995.

Growth factors such as Genentech provides may not always be enough to stimulate bone growth. That's especially true if the body is short on a rare type of bone marrow cell called mesenchymal stem cells, which give rise to new bone, cartilage, ligament, muscle, and tendon. Stephen E. Haynesworth and Arnold I. Caplan of Case Western Reserve University have discovered a way to replicate the rare cells and saturate a bone-like ceramic with them. Since the cells belong to the patient, tissue rejection shouldn't be a problem. Cleveland's Osiris Therapeutics Inc. has licensed the technology and begun large-animal trials.

After nearly 30 years in the field of bioceramics, Larry Hench is still awed by the idea that materials made from such simple components as calcium, phosphorus, and silica could help produce something as vital and complex as human bone. But then, Hench observes, the body itself is made of equally unimpressive ingredients.

By Ruth Coxeter in New York

Developments to Watch

EDITED BY PETER COY

MILITARY INTELLIGENCE TO KEEP BURGLARS AT BAY



It's a stormy night and your burglar alarm starts clanging. A break-in? More likely, lightning triggered your alarm. But in the next few years, nuisance alarms could become less common, thanks to advances in fiber optics, which are immune to electrical storms and other electromagnetic interference.

Military bases were the first to install loops

of glass fibers to protect their peripheries. Inside a loop, lasers pump beams of light in opposite directions. When the fiber is disturbed by pressure or sound, the relationship of the two beams changes. This "phase shift" is picked up by a photodetector, which generates an electrical signal that a computer interprets as a drop of rain, a falling leaf—or a thief. Such systems used to cost more than \$20,000 per loop. Thanks to the plummeting cost of electronic components, Mason & Hanger National Inc. in Huntsville, Ala., has brought the price of a loop down to \$3,400. Even so, industry leader Fiber SenSys Inc. in Beaverton, Ore., predicts it will be five years before systems show up in middle-class suburbs.

A BREAKTHROUGH IN WRINGING LIQUID FUEL FROM COAL

Synthetic fuel was supposed to alleviate America's dependence on imported oil by squeezing an oil-like liquid out of coal. However, synfuel hasn't delivered on its promise. A barrel of liquefied coal costs more than \$30, or at least 50% more than the real thing. But synfuel may get another chance, as a result of research at Pennsylvania State University.

Last year, Chunshan Song, an assistant professor of fuel science, hoped to trim costs by finding a better way of drying the black lumps before they're tossed into a high-pressure oven. Instead, Song stumbled on a "magic effect." By adding more water and lowering heat and pressure, he got a radical improvement in liquefaction efficiency. "We couldn't believe it," says Song. So his research team double-checked—and finally went public on Aug. 23. If the technique can be scaled up to a commercial process, Song predicts a "major impact" on costs, because the approach is four times as fast as previous ones and less expensive to operate. Moreover, it works with subbituminous coal, the cheapest type.

PURGING NUCLEAR WASTE, RUSSIAN STYLE

Russia has gotten bad press lately as the source of contraband plutonium and the home of unsafe nuclear plants. But in the field of radioactive-waste disposal, the Russians are making some valuable contributions. The U.S. Energy Dept. is working with scientists from the V.G. Khlopin Radium Institute in St. Petersburg on a process that could reduce by 90% the

volume of one kind of radioactive waste that must be formed into glass for long-term storage. That could save billions of dollars. The process is being used on highly radioactive waste that were generated from reprocessing of spent fuel. It uses carbon dicarbollide and other reagents to separate radioactive nuclides from other waste components such as nitric acid. Only the nuclides need to be vitrified.

The Russian method was a "great, great" success in tests at the Energy Dept.'s Idaho National Engineering Laboratory. Clyde W. Frank, Deputy Assistant Secretary for technology development, announced in August. The concentrated radioactive materials wouldn't appeal to nuclear terrorists because they contain little plutonium or uranium.

MORE MOVING PICTURES WILL SOON INVADE YOUR PC

Get ready to see lots more video on the screen of your personal computer. A soon-to-be-announced industry standard could stimulate rapid development of games, corporate training materials, and other software that includes full-screen full-motion video. So far, only one company, Sigma Designs Inc. in Fremont, Calif., makes a plug-in board for PCs that can handle video stored on CD-ROMs in the so-called moving picture experts group (MPEG) format. But lots of other companies are getting ready to jump in.

The problem is to create software that interacts with the plug-in boards in a predictable way. To avoid a profusion of different so-called application-programmer interfaces, key industry players formed a standard-setting committee. The committee's original idea was to come up with an alternative to Sigma Designs' proprietary standard. But that could have taken a year or more. To speed things up, C-Cube Microsystems Inc. in Milpitas, Calif., whose MPEG-decompression chip forms the heart of MPEG video boards, brokered a deal in August for the industry group to adopt most of the features of Sigma's standard. The agreement is set to be announced in late September.

SMARTER THAN THE AVERAGE ANT, IT'S ROBO-ANT

Keeping ants behind glass is one way to study how intelligent behavior emerges from simple instincts. But Luis R. Lopez, a scientist at an Army research laboratory in Huntsville, Ala., has formed a company to offer an even more entertaining alternative: an antlike robot called Insecta.

Insecta can outlearn ants. Fed a few simple software rules, the robot evolves increasingly complex operations. Its genetic algorithms start with snippets of software that combine and exchange data, and automatically create more complex programs. For guidance, Insecta will use neural networks, or circuits that mimic the reasoning powers of the human brain. Finished Insecta robots and software will be ready by yearend for \$800 and up. Lopez' new company, Ublige Software & Robotics Corp., will also offer kits, optional sensors and modules for do-it-yourselfers fascinated by artificial life.



The health care company was sick of rising workers compensation costs. We suggested that

The Company Needed Strong Medicine. they try

a Liberty Mutual loss prevention program, combined with managed care and return-to-work programs.

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DID THE AMEX TURN A BLIND EYE TO A 'SHOWCASE' STOCK?

The bizarre Printron case shows the exchange too often ignores the most glaring signs of trouble

Franks J. Barnes stood on the mezzanine of the American Stock Exchange, watching the balloons. It was Mar. 18, 1992, the birthday of the Emerging Company Marketplace, the Amex' showcase for "some of the best companies in the country," and the balloons cascading onto the trading floor were a patriotic red, white, and blue.

Sure, it was a corny spectacle. But the 49-year-old Barnes, a marketing consultant from Long Island, couldn't help but feel excited. Only six weeks before, after closing on the sale of his house, Barnes had deployed a huge slice of his nest egg—\$217,000—to buy shares in a company that, he was assured, would likely be among the ECM's charter listings. And when the ECM roster came out, there it was: Printron Inc.

Printron was an enticing combination of political correctness and profit potential, for it was pioneering a pollution-free process for manufacturing printed circuit boards. Its chairman and chief executive officer, 56-year-old Eleanor Lorraine Schuler, was an American success story. In her wildly varied career, she had been a welder, entrepreneur, corporate executive, and even a pistol-packing Federal Bureau of Investigation double agent who had battled Soviet spies during the Cold War. But she didn't like to talk about that.

CHECKERED RECORD. As Barnes watched the festivities, the conservatively dressed Schuler was but a few feet away, also looking on as the balloons fell and as Securities & Exchange Commission Chairman Richard C. Breeden rang the opening bell. Schuler would not be interviewed for this article, so her emotions on that day can only be guessed at. But when Breeden rang that bell, her feelings were, very likely,

mixed—for along with her many accomplishments there was a stain on her record. She had twice been sued in Federal Court by the SEC, twice agreeing to injunctions, without admitting or denying guilt, that prohibited her from violating the securities laws. One of the injunctions was known to the Amex when it approved Printron's listing on the ECM. The other was not.

Eleanor Schuler had two records of alleged securities law transgressions—one as a woman, and one as a man. In fact, the name "Eleanor Schuler" was one that she had made up out of thin air. Before a sex-change operation in the late 1970s, she had used the name her parents gave her: John Huminik Jr. Her earlier SEC record, and her change in gender, were concealed by Printron not

only from Barnes but from the Amex' "blue ribbon" panel of Wall Street notables that had handpicked the 23 ECM companies. Schuler also hid her previous identity, and the injunction, from securities regulators in New York, in a "sunshine law" filing 14 months before the day the balloons fell on the Amex floor (box).

March 18, 1992, marked the beginning of Frank Barnes's nightmare—and he was far from alone. The Albuquerque-based company—along with most of the charter ECM roster—has been a disaster for investors. And the Amex is still reeling from the ECM imbroglio, even though its greatest embarrassment, Printron, has never been publicly aired. The executive director of the ECM, Mark Klein, refused comment.

HE DID/SHE DID: PRINTRON'S PAST

Before becoming Eleanor Schuler, John Huminik Jr. ran two companies that the SEC accused of fraud. Later, she signed another consent decree. The SEC may have thought they were two separate people.



n Printron, the Amex's selection process, or any element of the Schuler/Huminik affair, saying that the exchange doesn't talk about companies that are no longer listed. (Printron withdrew from the ECM in March, 1993, because it had ceased to meet the ECM's listing standards.) Printron CEO Donald C. Wunsch says that Printron fully complied with the law in its public disclosures.

SEVERE STRAITS. Printron epitomizes the woes that have beset the uncouted thousands of investors who bought into the ECM charter stocks. Printron stock, which traded at \$14 a share on that glorious March day, now changes hands at less than the cost of a postage stamp—10¢. The company, its filings disclose, is in severe financial straits. The vaunted "Printron process" for manufacturing recruit boards, which Barnes says he was assured would begin producing revenues in 1992, has come to naught. And Barnes is pursuing a lawsuit against Printron, Schuler, and other defendants. Among other things, he maintains that Printron reneged on an agreement to fund his \$217,000. Wunsch, who replaced Schuler as CEO but not as chairman, in March, 1993, says that the company is vigorously contesting the allegations. He declined further comment, calling Barnes a "troublemaker." Trouble, alas, has been the ECM's midlife name. Of the 23 stocks in the ECM, 19 have fallen like lead balloons, or ceased trading entirely, since the day



HUMINIK'S SEX CHANGE RECEIVED A LOT OF PUBLICITY IN THE '70S

the balloons fell (table, page 82). Meanwhile, the Russell 2000 index of small-cap stocks has sustained a rousing 23% gain. In light of the ECM charter members' awful record, the story of Printron is as illuminating as it is bizarre.

The Barnes litigation paints a portrait of Printron that is even more dismal than its share price collapse would indicate. As alleged in the suit, which was dismissed on technical grounds in March and refiled the other day in U.S. District Court in Manhattan, Printron was little more than a fraud—a "sting,"

as the suit puts it, in which Barnes was the target. For the Amex, the Printron imbroglio raises fundamental questions about the ECM. How did Printron get past the gatekeepers at the Amex? Could the Printron fiasco be repeated? The answer to that question is disturbing—a firm "yes."

A good place to address these questions is at the very beginning—in the story of Eleanor Schuler's previous manifestation, John Huminik Jr. Born in a working-class neighborhood of southeast Washington, D.C., in 1935, the son of a Navy musician of Russian extraction, young John had, apparently, an ordinary childhood. He married his high school sweetheart—with whom he had four children—and served in the Air National Guard. He began work as a welder (a "welding engineer," as the Printron bio puts it) at 19.

MOONLIGHTING. Huminik never graduated from college—something that made his (and her) later achievements all the more remarkable. He studied metallurgy at night, and eventually, in Horatio Alger fashion, rose to the post of senior scientist at a company called Value Engineering. In 1963 he founded a chemical company, Chemprox. Meanwhile, Huminik was moonlighting. It was an unusual job. He was a double agent for the FBI and the Soviet government.

As recounted in his slickly written 1967 book, *Double Agent*, Huminik was recruited as a spy by agents working

out of the Soviet Embassy in Washington. In the adventures that followed, Huminik found himself, among other things, caught up in the disorders in the Dominican Republic in 1965. "I slipped my .45 pistol into my holster and headed for the city," goes one typical passage. But Huminik kept the FBI posted every step of the way, leading a double life for six years. In 1967, Huminik, a prosaic-looking man wearing horn-rimmed glasses, testified before Congress about the dangers posed by Soviet espionage.

Neither the book nor the double-agent career were mentioned in any of Printron's filings with investors and regulators. And that, apparently, is permitted by SEC rules that only require disclosure of activities within the past five years. What isn't so clear is just how much Printron had to

Name of Issuer Printron, Inc. Principal Office 8917 Adams Street, N.E., Albemarle, N.C.
Street Address City State Zip 87113
Telephone Number (505) 233-1990

8. Has registrant, any officer, director or principal or partner ever

- A. been suspended or expelled from membership in any securities or commodities exchange, association of securities or commodities dealers or investment advisors? Yes ☐ No ☒
- B. had a license or registration as a dealer, broker, investment advisor or salesman, futures commission merchant, associated person, commodity pool operator, or commodity trading advisor denied, suspended or revoked? Yes ☐ No ☒
- C. been enjoined or restrained by any court or government agency from:
1. the issuance, sale or offer for sale of securities or commodities? Yes ☐ No ☒
 2. rendering securities or commodities advice? Yes ☐ No ☒
 3. handling or managing trading accounts? Yes ☐ No ☒
 4. continuing any practices in connection with securities or commodities? Yes ☐ No ☒
- D. been convicted of any crime (other than minor traffic)? Yes ☐ No ☒
- E. used or been known by any other name? Yes ☐ No ☒
- F. been the subject of any professional disciplinary proceedings? Yes ☐ No ☒
- G. been the subject of any criminal proceedings? Yes ☐ No ☒

Each of the undersigned, constituting all officers, directors, partners, and controlling principals of the registrant do hereby state and represent that all statements contained herein are true and correct; and understands that any false statement shall constitute a violation of Art. 23-A of the General Business Law.

Signature

Name and Title (please type or print)

Date

Eleanor Schuler

Chief Executive Officer & Director

C. Stevens Avery, Jr.

1-15-91

IN A NEW YORK "SUNSHINE LAW" FILING, SCHULER CLAIMED SHE HAD NEVER BEEN KNOWN BY ANOTHER NAME

reveal about Schuler's history. At issue is not her sex change, but rather the extent to which her concealment of that change masked other things. "We have nothing against transsexuals," Barnes's lawyer Victor L. Zimmermann, formerly with the SEC's enforcement division, takes pains to point out.

"MATERIAL EVENTS." The trouble, from the Barnes perspective, arises whenever Schuler's pre-Schuler activities are mentioned in Printron's public disclosures. Time after time, they refer to Schuler as a "she"—even when discussing positions held when Schuler was a "he." Moreover, the filings say that Schuler was a "self-employed technology and corporate consultant" from 1966 to 1991.

In fact, Schuler, as Huminik, was president of General Industrial Corp. and General Enterprises Corp., which allegedly defrauded investors during the 1970s. According to a federal court suit that the SEC filed against Huminik and the two companies in December, 1975, Huminik repeatedly lied to investors about GIC. Huminik agreed to a permanent injunction barring him from making untrue statements, and otherwise defrauding investors, in the future. He agreed to the injunction without admitting or denying the SEC's allegations.

Was Schuler being shy—or was she improperly misleading investors? Wunsch maintains that Schuler was within her rights to hide her previous gender and to not disclose the 1976 injunction, because of the SEC rule requiring such disclosures only for five years. Zimmermann maintains that a previous injunction is a "material event" that must be disclosed beyond the five-year period set by the rules. Who is right? "If you ask a dozen lawyers, you'll get a dozen answers," observes Ira L. Sorkin, a securities lawyer and former head of the New York office of the SEC.

The GEC/GIC allegations drew nary a mention in the financial press. But the next Huminik/Schuler exploit received considerably more ink. As detailed in a lengthy article in the Style section of *The Washington Post* in December, 1977, John Huminik was no longer exhibiting a James Bond persona. "Marine blue shadow haloes the eyelids," the article

began. "What do you think?" she asks, for she really doesn't know if she is pretty. 'Judging from the number of men that chase me . . .' The low voice trails off." The *Post* went on to describe the sex change and, in graphic detail, how it affected every aspect of her life.

None of this would amount to a hill of beans if Eleanor Schuler, as Printron CEO, hadn't fallen afoul of the SEC. In September, 1991, the SEC filed suit against Printron and Schuler. The suit alleged that Schuler was brought into

that the issue had been resolved," panel member Nedim Hamarat, president of Beekman Capital Management Ltd., told *BUSINESS WEEK* at the time. But Hamarat and another former panel member L. Keith Mullins, a managing director at Smith Barney Shearson Inc., now say that the panel didn't know that Eleanor Schuler used to be John Huminik—that Schuler consented to not one but two injunctions by the SEC. If they had known, they say, Printron's listing would never have been approved.

The SEC's mild treatment of Schuler in 1991 raises yet another issue: Did the SEC know in 1991 that Schuler was Huminik? After all, the 1976 injunction barred the kind of conduct dealt with in the 1991 suit—alleged violations of Sections 10(b) and 17(a) of the Securities Exchange Act of 1934, which contain broad prohibitions against securities fraud. One explanation might be that the SEC felt so much time had passed that it would not pursue a criminal contempt action against Schuler. Stephen J. Crimmins, an attorney in the SEC's enforcement division, says he can't comment on the Huminik/Schuler matter because it may be the subject of an investigation. However, Crimmins says that normally a person suspected of contempt of a previous order is brought up on the charge immediately, without the interim step of a second consent decree—even if a second company is involved.

If the SEC didn't know that the Eleanor Schuler of 1991 was the John Huminik of 1976—and the Amex surely didn't know—there was one possible explanation. The central

registry of the National Association of Securities Dealers, the electronic bible of securities regulators nationwide, had John Huminik on its data base. And Eleanor Schuler, too. But they are listed as two separate people, with one "incident" to his name and one to hers. A NASD spokesman notes that more detailed information, such as social security numbers, is only maintained for NASD members—not corporate officers who fall afoul of the SEC.

So the SEC couldn't have found out anything by checking with the NASD. And as for the Amex—well, it never even tried. According to a study of the

THE CLASS OF '92: MOST ARE FLUNKING

Company	Share price		Percent change
	3/18/92	8/30/94	
ADVANCED PHOTONIX	8.125	2.188	-73.1%
ALTA ENERGY*	6.750	Not trading	
AMERICAN PACIFIC MINT	3.750	1.938	-48.3
AUDRE RECOGNITION SYSTEMS	4.875	0.938	-80.8
CANCER TREATMENT HOLDINGS	5.000	2.250	-55.0
COLONIAL DATA TECHNOLOGIES	1.875	4.750	153.3
DIGITRAN SYSTEMS*	3.063	Not trading	
EPIGEN	3.250	0.500	-84.6
INTERTEL COMMUNICATIONS	9.375	13.125	40.0
ION LASER TECHNOLOGY	2.969	0.938	-68.4
MEDIA LOGIC	3.380	1.875	-44.5
MEDPHONE	1.750	0.020	-98.9
NORTH COAST ENERGY	2.391	1.250	-47.7
NORTHERN INSTRUMENTS**	2.875	2.938	2.1
OCEAN OPTIQUE DISTRIBUTORS	6.359	3.688	-42.0
PNF INDUSTRIES*	9.250	Not trading	
PRINTRON	14.000	0.219	-98.4
PROFESSIONAL DENTAL TECHNOLOGIES	4.313	2.625	-39.1
RANDERS GROUP	1.782	0.688	-61.4
THREE-FIVE SYSTEMS	2.375	39.000	1542.1
TOP SOURCE	3.907	6.500	66.4
TOPOX*	5.375	Not trading	
UNIQUE MOBILITY	2.130	6.125	187.6
RUSSELL 2000			23.0%

*No longer trading

**Began trading 3/27/92

DATA: AMERICAN STOCK EXCHANGE, BUSINESS WEEK

the company by Karl R. Huber Jr., a convicted felon and disbarred lawyer. According to the SEC's allegations, which were neither admitted nor denied by Schuler and the company, Huber's hidden role in the company violated the federal securities laws. Schuler and Printron settled the charges by agreeing to a consent decree barring them from future securities law violations. "There were no victims. No shareholders were harmed," Schuler told *BUSINESS WEEK* in an article on the ECM in April, 1992.

The Huber-Schuler ties were shrugged off by the blue-ribbon panel. "We were assured by the Amex staff

ECM last May by the General Accounting Office, the investigative arm of Congress, the ECM tightened its screening procedures in the spring and summer of 1992, and that included checking computer databases such as the NASD's. But even so, the GAO observed, the Amex continues to allow companies on the ECM even if they have no earnings or revenues or are losing money when "the companies were judged capable of improving their finances in the future."

With marginal companies still permitted on the ECM, it's far from clear if the Amex has learned the lessons of Printron and the other troubled companies that found their way on to the ECM. In an interview, the ECM's executive director for the past year, Mark Klein, said that he is "trying to position the ECM as a superior alternative to the NASDAQ small-cap marketplace." The main obstacle, he believes, is one of PR. There has been, he feels, too much "bad press." His "mission," he says, is one of marketing—to correct misconceptions about the ECM and "disseminate the facts to the target market," the small companies targeted by the Amex and the NASDAQ in the hunt for listings. Klein claims statistics show that companies that move to ECM from NASDAQ get dramatically narrower spreads between bid and ask prices.

DOUBLE-DIGIT DECLINES. But as for performance, ECM statistics are far less glowing. In fact, they stink. The Amex's own figures show that 40 of the 60 ECM companies that have listed to date—one as recently as last June—have declined since their listing on July 1. And although there are a few isolated winners, the losers are largely awful, with 38 sustaining double-digit declines in a generally up market. Moreover, the data were skewed in Amex' favor because the list does not include companies that have stopped trading.

The Amex no longer advertises the ECM as the champagne of small-cap markets, and its screening panel is no longer called "blue ribbon." But the Printron disaster and the miserable performance of the other ECM companies make it plain that the Amex hasn't done far enough. By allowing on to the ECM a host of clearly marginal companies, the Amex is alienating its ultimate target market—the Frank Barneses of the world. Small time, retail investors have long sustained small-cap stocks. Some of them have made the mistake of believing that the ECM was a conglomerate of the best companies in the country. Clearly that was a tall order. But if ECM companies can't be among the best in America, is it too much to ask that they not be among the worst?

By Gary Weiss in New York, with Michael Schroeder in Washington

DEALS

LBO HOT-RODDERS RETOOL

Firms are looking far beyond traditional buyouts

A few years back, Wall Street investment firm Blackstone Group was playing the leveraged buyout game like everyone else. Among its big acquisitions were Chicago & North Western Transportation Co. and the Six Flags theme-park chain. But after Black-

competition stiff, and affordable companies scarce, today's buyout mavens are looking for deals in unlikely places and pursuing a variety of new strategies. "It's the evolution of the LBO business," says J. Tomilson Hill, a Blackstone general partner who played in the 1980s

takeover game as a top-level Lehman Brothers investment banker. "You can't just sit with a pool of money waiting for the phone to ring, for somebody to say: 'Here is a company to buy in an auction.'"

CASH SURGE. Even the term "leveraged buyout" no longer describes what many firms are doing. Some prefer to be known as "private equity" investors. In part, that's because of the bad name LBOs got in the 1980s takeover frenzy. But also, today's deals involve much less leverage. Some of the current investments are not even buyouts but involve taking minority stakes, purchasing bank debt, or pursuing novel tactics such as "leveraged buildups."

Behind the fragmentation of the buyout industry is a familiar tale: too much money chasing too few deals. Although both buyouts and the amount of money flowing into them slowed after the late 1980s, cash has poured into the sector in the past few years. Indeed, Steven P. Galante, editor of *The Private Equity Analyst* in Wellesley, Mass., predicts that buyout funds will raise a record \$11 billion this year, up 53% from last year and even greater than the 1987 record of \$10.2 billion (chart, page 84).

In part, the surge may be cyclical. It's been four or five years since many big buyout firms raised a lot of money, and now they're simply going back to satisfied investors for more. But there's also a more fundamental dynamic at work. Enticed by returns for buyouts that dwarf those for traditional invest-



Behind the fragmentation of the buyout industry is a familiar tale: too much money chasing too few deals

stone raised a new \$1.3 billion war chest late last year, its first deal wasn't a buyout at all. Instead, Blackstone shelled out \$50 million for a majority stake in a startup reinsurance company, La Salle Re Ltd.

Forget *Barbarians at the Gate*. The swashbuckling leveraged buyout firms that swaggered across the financial landscape in the late 1980s have matured, even mellowed. With stock prices high,

ments, many pension funds and other institutions have upped the percentage of their portfolios earmarked for the sector. At the same time, overall pension assets are increasing, so buyouts are getting a bigger piece of an expanding pie. "There's plenty of money available," says Robert F. Johnston of Beacon Hill Financial Corp. in Cohasset, Mass., who helps raise money for buyout funds. "The existing [buyout] groups will continue to be funded, unless they really screw up."

Finding places to invest all the money has kept fund managers scrambling. Kohlberg Kravis Roberts & Co. has barely touched a \$1.9 billion fund it raised a year ago. And Forstmann Little & Co. hasn't done a deal for more than a year—it still has some \$2 billion in unused funds.

The problem: With the stock market at such high levels, most deals involving public companies or their divisions are too pricey. When an attractive private company comes up for sale, there are so many hungry buyout groups on the prowl that they find themselves bidding against each other. One example: the auction of U.S. Playing Card Co. a few months back. The private Cincinnati-based company, whose Bicycle and Bee brands dominate American poker and bridge tables, elicited more than two dozen bids, primarily from buyout firms, says one insider. Although some bidders thought the company wasn't worth much more than \$120 million, it eventually fetched about \$155 million from a group of Cincinnati investors who are allied with management.

SMALL BUT PROMISING. Hence the search for new ways to invest. One twist to the traditional financing is the so-called leveraged buildup. Instead of paying big bucks for a leading company in a field, a buyout firm acquires or starts a small company and uses that as a platform from which to make acquisitions. In theory, the management discipline instilled by the buyout firm creates value, while the enlarged company can later be taken public or sold at a higher price. The best-known proponent of the technique is KKR, which is becoming a force in publishing through K-III Communications Corp. and has been gobbling up upscale golf resorts through KSL Recreation Corp.

Many buyout firms are taking unleveraged minority stakes in companies, previously anathema to LBO managers who felt they needed a certain degree of control to exercise the kind of tight discipline required for squeezing

out costs. Another strategy, popularized by Boston financier Thomas H. Lee, famed for the Snapple Beverage Corp. deal, is the so-called growth buyout. Rather than buy stable companies in order to milk their cash flow, as in a traditional LBO, Lee tries to spot promising companies in hopes that they will grow quickly.

Then there are players such as Leon D. Black's Apollo Advisors LP, best described as opportunists. They delve into everything from distressed debt to minority investments to full-fledged buyouts. "You have to be able to seize opportunities as they present themselves," says Philip Pool, a banker at Donaldson, Lufkin & Jenrette Securities Corp. Pool helps fund managers raise money. "One strategy could be good for one environment, but disastrous for another."

The maturation of the buyout industry also has spawned hordes of niche players. Los Angeles-based Bastion Capital has just raised \$80 million to invest in buyouts of companies that serve ethnic minority groups. Boston-based Heritage Partners claims to be the first fund aimed at deals involving family-owned companies. And a host of groups have sprung up trying to tap into the craze for international investing, especially in Asia.

"It's almost a gypsy-like community," grouses Leslie A. Brun, head of Philadelphia-based Hamilton Lane Advisors Inc., which advises pension funds on alternative investments. "Whatever is hot in the marketplace, within nanoseconds a number of people are parading through the door, saying they're the best."

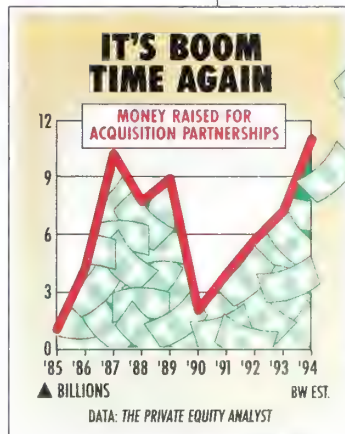
Even some industry veterans wonder if risks will rise as firms delve into unfamiliar territory. "People labeled LBO experts have been transmuted into something more exotic," says Tully M. Friedman, a managing partner at the big San Francisco private equity firm Hellman & Friedman, which has long done nonbuyout deals. "The question is whether they know what they're doing in these exotic areas." Although most investors are still expecting annual returns of 20%, they could be in for a shock if the innovative strategies that are pursued by the LBO managers don't work as planned.

"VERY TRICKY." A hard-nosed management technique was the major edge for buyout firms in the past, says Michael C. Jensen, a Harvard business school professor who has championed LBOs. "If all they're doing is putting out capital, they have no comparative advantage," he says. And buying growing firms rather than the stable, cash-generating ones usually favored by LBO operators, he adds, "is very tricky. It's incompatible with high debt and involves a very different management philosophy." Still, Jensen remains optimistic that the best LBO managers are nimble enough to make the leap.

Pension fund managers who invest in private equity funds are aware that the business has become much tougher. "It certainly puts pressure on the ability to find good transactions and get the kinds of historical returns we've seen," says Russell W. Steenberg, who manages the alternative investment part of AT&T's \$35 billion pension fund. "But this business is full of smart, opportunistic investors. Those who adapt to the market will do the best. It's still a wonderful investment area."

Think of it this way: If the heady early 1980s was the youth of the buyout business, and the wild and crazy late '80s was its adolescence, today we're into full-fledged adulthood. With maturity has come more cash in the bank, more wisdom—and a lot more hard work.

By Mark Maremont
in Boston



LOOKING FOR CASH

MONEYRAISING CAMPAIGNS OF MAJOR BUYOUT PLAYERS

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DATA: THE PRIVATE EQUITY ANALYST, BUSINESS WEEK

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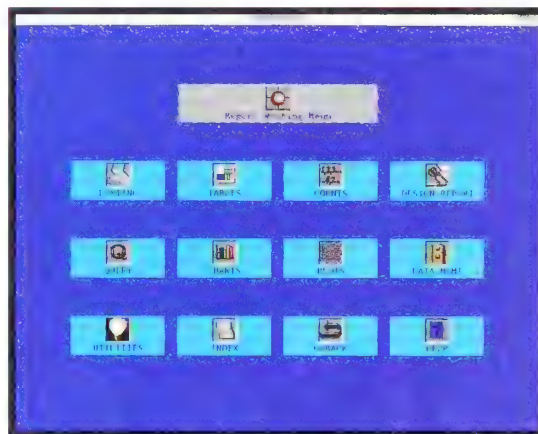
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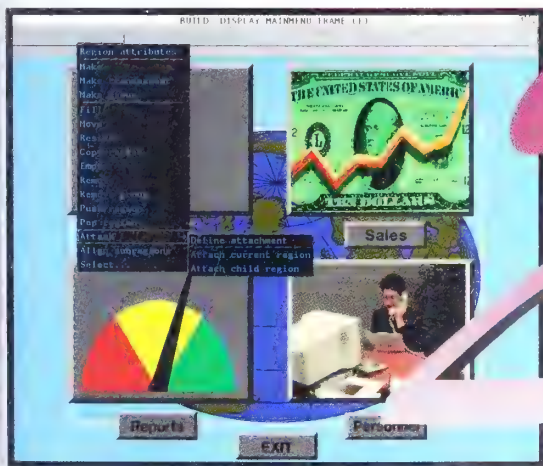
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BY GENE G. MARCIAL

TIME WARNER: SET TO SPIN OFF THE MAGAZINES?

Time Warner is back in the rumor mill, after a brief break from buy-out stories and other speculation. Some investors with big stakes in the media and entertainment giant believe a restructuring is in the works—and they suspect it will involve publishing operations.

According to these pros, Time Warner discussed selling most of the company's magazines, including flagship *Time*, with mogul Rupert Murdoch a few months ago. The idea was that Murdoch might be interested in *Time* and the other magazines for his News Corp. But talks with Murdoch didn't produce agreement, say the sources.

Now, the buzz is that management intends to sell part of its publishing operations to the public instead, possibly 40% of the unit. The division has been a solid performer for the company, and lately management has been reminding analysts of its hefty gains.

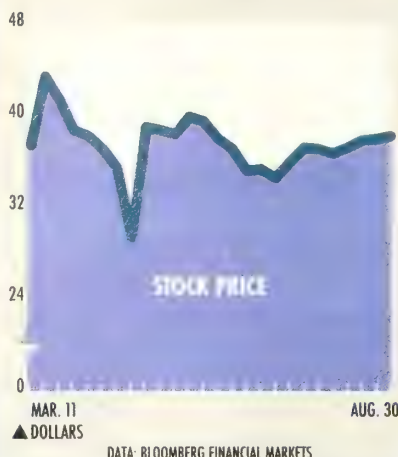
But spokesman Ed Adler says Time Warner Chairman and CEO Gerald Levin denies "all aspects of the rumors" and calls them "absurd." News Corp. spokesman Bill Sorenson declined comment as a matter of policy.

One analyst estimates the Time Inc. publishing division, including *Life*, *Fortune*, *People*, and *Sports Illustrated*, is worth \$4.5 billion to \$5 billion. He calculates that it generated pretax and predepreciation earnings of \$425 million last year. In 1993, the division accounted for 22% of the company's total revenues of \$14.5 billion.

PLATEAU AHEAD. Publishing operations "should remain Time Warner's best-performing division over the near term," says Jessica Reif of Merrill Lynch. She notes that second-quarter publishing revenues were \$851 million, up 4% from a year ago. Circulation rose 3%, and advertising jumped about 10%, with impressive results coming in *People* and *Southern Living*.

Reif says Time Warner is "superbly managed." But she sees no significant slow growth, "because the company is spending billions of dollars to build its cable plant and could spend \$1 billion to \$300 million or more to develop a fifth broadcast network." The company has repeatedly denied

WHY TIME WARNER NEEDS A BOOST



it would put publishing operations on the block. It also rejected stories it was thinking about a merger. Such tales stemmed from Seagram's acquisition of a 15% stake in the company. Seagram President Edgar Bronfman Jr. has denied any hostile intentions toward Time Warner. But it's hard to imagine that the Bronfmans are happy with how their investment has stayed under water. And they also couldn't be thrilled by the stock's lackluster performance: from 44 a share in March to its current 38.

TRIDEX MAY WIN THE LOTTERY ORDER

Tridex is a little-known company that hopes to make a big mark in gambling and wagering. That's one reason some players have been placing heavy bets on its stock, now trading at 6 a share on the American Stock Exchange.

What's the big deal about Tridex? Whispers are that it will soon sign a lucrative contract with GTech Holdings, a major provider of lottery services to government authorities and licensees worldwide. Tridex makes custom-designed dot-matrix printers used to print such items as lottery tickets, bank statements, and receipts. Tridex also makes point-of-sale printers for major retailers.

A big supplier of its own on-line lottery terminals to retail outlets, GTech has chosen Tridex to produce the terminal printers for its new lottery systems under an exclusive five-year contract, says one big investor. Earlier

this year, GTech ordered 2,500 of Tridex' new printers and was apparently satisfied, says this pro, who has bought a stake in Tridex. Tridex Chairman and CEO Seth Lukash wouldn't confirm or deny the GTech story but says: "Tridex has very good relations with GTech."

Jack Silver, president of Silver Investment Advisory Research, figures that the GTech agreement will produce Tridex sales of \$40 million to \$50 million over five years. Tridex expects to boost revenues by 1997 to \$100 million—up sharply from last year's \$33 million. For 1994, Silver estimates Tridex revenues will rise to \$50 million. He expects Tridex, which earned 44¢ a share last year, will make 60¢ this year and 95¢ in 1995, when he sees sales jumping to \$70 million. Silver expects the stock to double in a year's time.

AN ICEBERG THAT JUST MIGHT SINK

Bulls and bears are jousting over Storage Technology, which so far has pleased the bulls. The stock is at 36, up from 23 in mid-May. Bulls see it boiling to 50. No way, assert the bears, who predict it will plunge to 15. What's the big fight about?

It's mainly about Iceberg. No, that's nothing to do with chunks of glaciers. Storage Tech makes high-performance subsystems for storing and retrieving computer information on disk and tape, mainly for mainframe and midrange systems. Storage Tech is counting heavily on Iceberg—a new product it describes as an array of independent disks designed to slash the cost of managing a disk-storage subsystem.

But Mike Murphy, editor of the *Overpriced Stock Service*, believes Storage Tech is now discounting Iceberg in a big way because of a rival IBM product. If that's so, says Murphy, Storage Tech "will have a real profit-margin problem."

Another big bear on the stock agrees. For 1994 and 1995, he sees earnings way below the Street's expectations. For 1994, he expects \$1.20 to \$1.36 a share, vs. analysts' average of \$1.71. For 1995, this bear expects \$2.50 vs. the Street's \$3.44 to \$4.25. "Price competition has been beating up the industry, and Storage Tech is losing ground significantly," he argues. A spokesman insists that the company hasn't done any "extreme discounting



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PDA: PREMATURE DEATH ANNOUNCEMENT

Learning from Newton's errors, makers pin hopes on a new breed

Remember when Apple Computer Inc. introduced its much-ballyhooed Newton personal digital assistant (PDA) last August at a celebrity-studded press conference? The excitement faded fast in the face of the public sniping, low sales, and *Doonisbury* cartoons that made Newton out to be an electronic Edsel. It looked like the quick end of a grand vision—that millions of people would rush to buy handheld devices that recognize handwriting, send and receive messages, place phone calls, and do a little computing on the side.

Not so. Computer makers have plowed too much money and time into developing PDA technology. With Newton's failings to guide them, they've gone back to the drawing boards. Now, a new wave of PDAs is coming. It started in August with BellSouth Corp.'s Simon, a cellular phone that handles faxes, electronic mail, and voice calls.

In the next two months, long-awaited PDAs from Motorola Inc. and Sony Corp. will arrive. They're the first to use software from General Magic Inc. that should make second-generation PDAs more marketable. The Magic Cap operating system and Telescript communications program are also the basis for AT&T's PersonaLink service, an on-line network that can send a message to someone via phone, pager, or PC. AT&T, Motorola, and Sony are all investors in General Magic, an Apple spin-off.

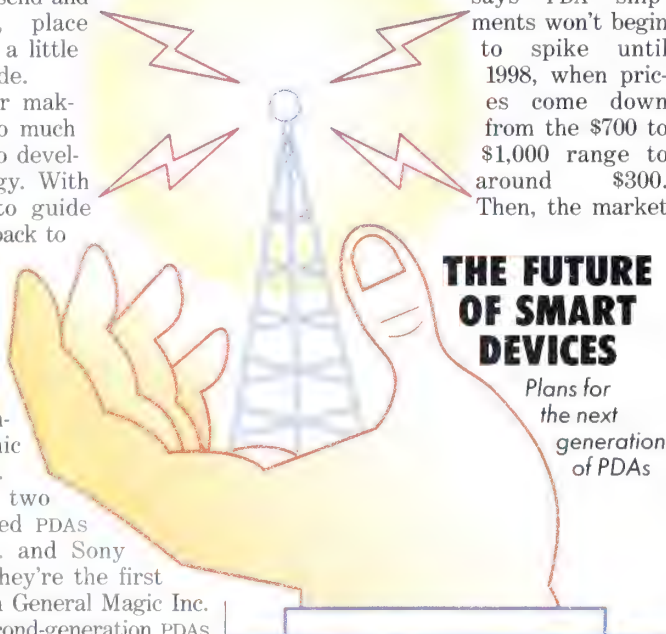
WAITING GAME. These machines—and Simon—emphasize communications. Continuously absent: the tricky handwriting-recognition technology that tripped Newton. Instead of a glorified date book, marketers now say, what people want is anytime, anywhere voice and data links. "The world is looking to be connected," says Anthony E. Santelli,

general manager of IBM's Power Personal Systems Div., which is at work developing a gizmo based on the IBM-Motorola PowerPC chip.

No one is expecting a mass conversion. The new conventional wisdom has a consumer market for PDAs building over six to eight years instead of in two or three, as projected when Newton came out. Scaling back

earlier estimates, Forrester Research Inc.

says PDA shipments won't begin to spike until 1998, when prices come down from the \$700 to \$1,000 range to around \$300. Then, the market



THE FUTURE OF SMART DEVICES

Plans for the next generation of PDAs

BELL SOUTH Its new Simon is a cellular phone with smarts.

AT&T Working on a phone with computing capabilities, plus a pen-based tablet PC. Both use its PersonaLink wireless messaging service.

SONY Readying a product based on Magic Cap operating software by General Magic.

MOTOROLA Using Magic Cap in its Envoy due this fall. Communicates over Motorola's Ardis network.

APPLE New Newtons target specific markets such as health care. Also developing new operating system.

researcher predicts, sales could hit 2.5 million units. In the meantime, manufacturers are carefully aiming at well-heeled traveling executives or specific vertical markets, such as hospitals or claims adjusters.

The PDA world could certainly use a little realism. Apple, after selling only some 80,000 to 90,000 Newtons in a year, laid off 20% of the workers in its Personal Interactive Electronics Div., which makes Newtons. Eo Inc., a start-up partly owned by AT&T, sold fewer than 10,000 PDAs in a year and was shut down in July. Intel Corp. just ended a deal with VLSI Technology to develop a PDA chip set. Compaq Computer Corp. canned its Mobile Companion on the eve of shipment: The Newton debacle convinced the PC maker to start over.

PROMISING SOFTWARE. Simon is being hailed by consultants as the first step in reviving the market. The 18-ounce device, designed and built for BellSouth by IBM, has a liquid crystal display with a keypad and touch screen. Owners can send E-mail and faxes over the BellSouth cellular network by touching the keypad and icon-driven menus. Or they can scribble notes with "digital ink," but the computer doesn't try to decipher them. Analysts say its communication capabilities are a huge step forward.

Simon isn't nirvana, though. The list price, for one thing, is high—\$899 for subscribers to Atlanta-based BellSouth Cellular, \$1,099 for nonsubscribers. And there aren't many applications available for its proprietary operating system.

More promising could be the spate of products based on Magic Cap. The software is meant to work on everything from PDAs to PCs to cable-TV boxes. Magic Cap is almost a year late, but General Magic President Marc Porat says a finished version has been shipped to Sony, Motorola, and AT&T. Consultants and executives who have seen the give General Magic software high marks. "The underlying technology is really exceptional," says Timothy Bajarin, president of market researcher Creative Strategies International. An industry executive notes: "Everyone in the industry is at least looking at it."

The first test of Magic Cap will come in September. That's when Sony plans to bring out a sub-\$1,000 device using the software. It can send and receive faxes and tap into PersonaLink service such as on-line investing, shopping, and the booking of airline tickets.

The kind of consumer who needs to trade stocks from virtually anywhere may not care about costs. But cellular phone rates are pricey for data. To cu

he cost, Motorola's Envoy PDA will use the company's Ardis radio paging service initially. The trade-off: no voice.

The PDA market could get a big boost from the new wireless technology called Personal Communications Services (PCS). Basically a low-range cellular service for voice and data, PCS promises low transmission costs, broad coverage, and cheap receivers—but not for at least a year.

Meanwhile, even the companies that looked like they were retreating are preparing second acts. Intel says it's developing special versions of its 486 microprocessor for PDAs. Apple is rewriting the Newton operating system with improved communications functions and still holds out hope for a huge consumer market—someday. "We're going to just keep plugging away," says Apple fellow Steve Capps. "Windows didn't hit its stride for eight years."

A big push could come precisely from Windows. Microsoft Corp. is pressing ahead with WinPad, a PDA operating system that promises smooth links to millions of desktop PCs running Windows. But WinPad is taking a lot longer than expected, and some software developers say it won't be ready until next year. Microsoft reports Compaq, Motorola, Toshiba, Sharp, NEC, Zenith, and Olivetti have all signed up to use the system in future handhelds. But the software giant is taking a cautious approach: "This is not viewed as a consumer product," says David D. Britton, Microsoft's group product manager for handheld systems. "Handhelds are for people, traveling executives, and entry-management professionals."

Underestimating the market's potential could be as much of a gaffe as Apple's initial overhype. "The people who apply technology can neither predict nor control how it will be used," says Richard J. Rosen, president of New York-based software developer Logicom. "No one could have predicted that the PC would create a huge desktop publishing industry. The same holds true for PDAs." Perhaps. But that's a vision it is still several years down the road. By Catherine Arnst, with Amy Corbin in New York and bureau reports



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DANGEROUS LIVING IN TELECOM'S TOP TIER

Now LDDS is a big-leaguer—and looking good to other predators

By finally capturing long-distance transmission company WilTel after three months of negotiations, LDDS Communications Inc. has opened the door to new speculation. It could continue growing and vie with Sprint and MCI for the share of the long-distance market that dominant AT&T doesn't control. Or it can wait for a Baby Bell to gobble it up when Congress clears the way for them to compete in the long-distance business. Sprint, MCI, or even an information-services company such as Electronic Data Systems Corp. also might be potential LDDS acquirers.

Interesting possibilities, all. But in the interim, the long-distance operator, based in Jackson, Miss., has some issues to deal with in the here and now. The \$2.5 billion cash purchase of WilTel, announced on Aug. 22, comes fresh on the heels of the signing of a definitive agreement on Aug. 1 to acquire international telecommunications player IDB Communications Group Inc. in a \$700 million stock swap. If the deals come off, the combined companies will have revenues of more than \$3 billion.

But LDDS will still only be the No. 4 long-distance player, with a scant 3% of the market. And LDDS Chief Executive Bernard J. Ebbers must prove that he can pull together the three operations under intense competitive pressure. "Can we handle it?" asks Ebbers. "I guess that remains to be seen."

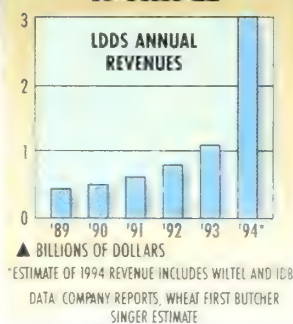
OVERSEAS CONNECTION.

Ebbers, of course, sees the deal as a golden opportunity. Until now, LDDS has leased phone lines from larger rivals. Gaining access to Tulsa-based WilTel's 11,000-mile network, Ebbers figures, will cut leasing costs that would have topped \$140 million next year. And, he says, it will enable LDDS to add new customers without adding leasing costs. WilTel, moreover, generates handsome profits: Mabon Securities Corp. expects earnings of \$110 million this year on reve-



WILTEL IN TULSA: THE \$2.5 BILLION PURCHASE ALLOWS LDDS TO OWN TRANSMISSION LINES

HOW TO HIT A TRIPLE



nues approaching \$1 billion. That, and no WilTel debt, convinced bankers to lend Ebbers the entire purchase amount and roll LDDS's remaining debt into a new \$3.2 billion loan.

The other big advantage of the deal: it may finally allow LDDS to go after the lucrative business market. WilTel's national system is all digital, which Ebbers hopes to market as a big advantage over rivals. And IDB will dramatically increase LDDS's international business, which currently amounts to only about 4% of sales.

There's plenty of room for second-guessing the WilTel deal. After initially bidding \$2 billion for the company in May, Ebbers raised the offer to \$2.5 bil-

lion to lure a reluctant Keith E. Bailey, CEO of parent Williams Cos., into the deal. The final tab: a hefty 17 times earnings. "Williams got a very attractive price," says Robert L. Christensen Jr. of Mabon Securities. Adds Bailey: "Now it's up to them to prove the price they paid was worth it."

That may be hard to do. Because of glut in fiber-optic-cable capacity, it may not pay to own a network at this point.

Since 1989, the price for leased-cable rates have dropped some 80%, says Gerald Taylor, president of MCI Communications Corp., figures that in today's telecom market, long-distance operators can do just as well leasing as owning when the costs of depreciating equipment are factored in. "This move doesn't buy him efficiencies or intelligence [advanced network management features]," says Taylor. "What he does get is a company with significant market share."

AUCTION TIME? Taylor says Taylor, suddenly makes LDDS a far more attractive takeover candidate. He figures the best fit could be with a computer-services company. With a long-distance arm, such a company could sell comprehensive information-network "solutions" to corporations. "I think they would be great if

EDS. IBM needs one, too," says Taylor. So far, LDDS's competitors are hardly shaken. "This doesn't change the industry equation," says Sprint spokeswoman Susan Kraus, who declines to comment on the possibility of a Sprint takeover. But there is another factor that could shake Some investors expect dealmaker John W. Kluge, who controls a 20% stake through his Metromedia Co., to push a sale of LDDS to a competitor. Partly because of the takeover talk, LDDS shares have bounced back to around \$24, up from \$14 after a disappointing first-quarter earnings report. But if the WilTel merger and the IDB deal work out the way Ebbers hopes, it might pay to bet on the long-range prospects of LDDS as a scrappy No. 4 in the long-distance race.

By David Greising in Atlanta, with Peter Burrows in Dallas

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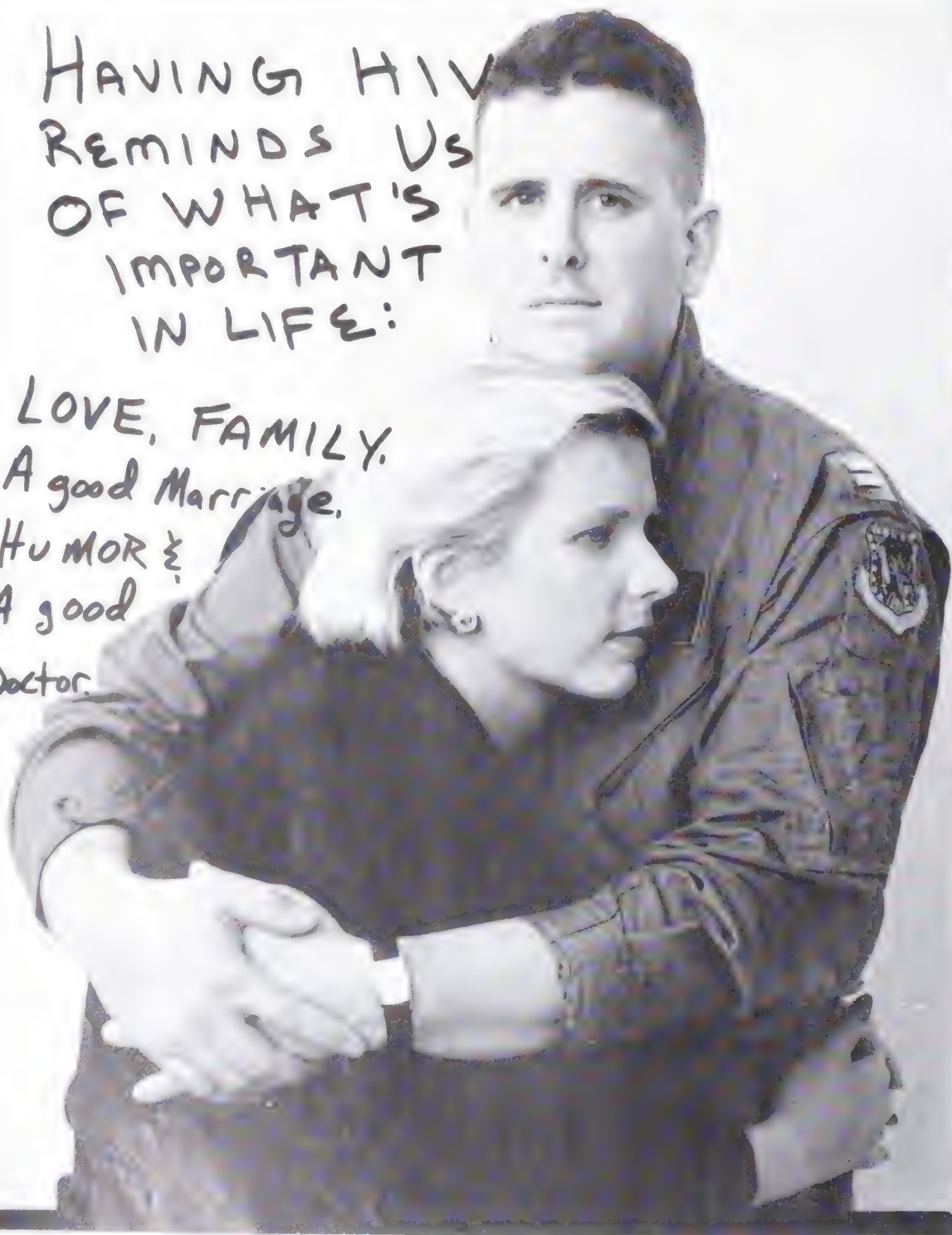
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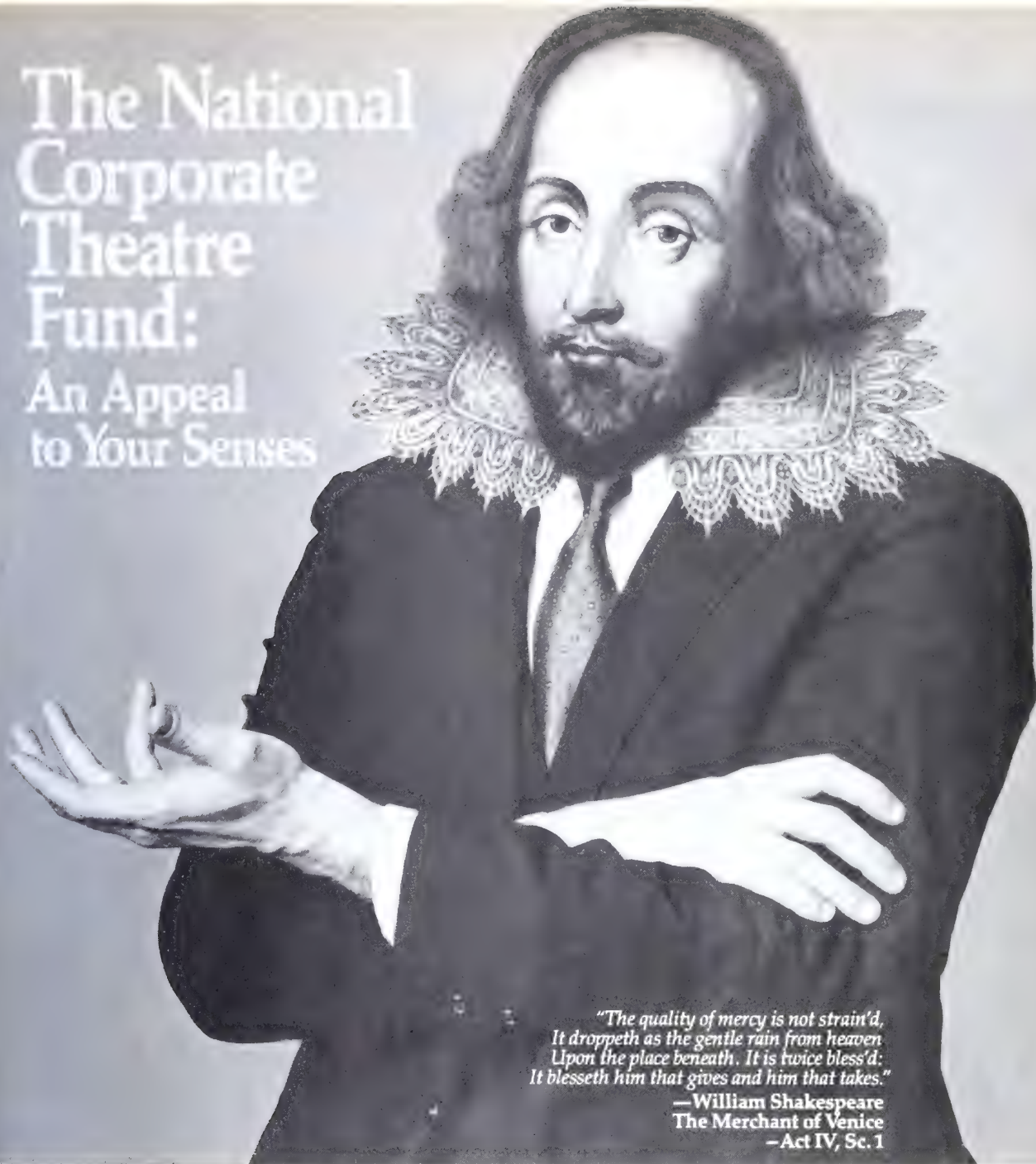
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SPAIN'S PHONE GIANT HAS LATIN AMERICA BUZZING

Telefónica's success there could make it a major global player

Telefónica de España is determined to be a global player in telecommunications—and the cost be hanged. That's why, when the Spanish telephone company sought a stake in Peru's telephone operator in January, it blew away rivals with a bid of \$2.02 billion, more than double the next highest offer. Peru is now part of an estimated \$5 billion worth of Telefónica holdings in Latin America—the fastest-growing region of the world after Asia. The company even has a beachhead in the U.S. with its 79% stake in Puerto Rico's long-distance carrier TLD.

Suddenly, the \$10 billion public carrier is being hailed as a visionary—a huge change for what had not long ago been one of the least esteemed of European carriers. As William Coleman, an analyst with James Capel in London, notes, "Telefónica has one of the most attractive, if not the most attractive, portfolio investments in telecommunications in the world."

Ask GTE Corp. or AT&T. They're among those sparring to pay an estimated \$1.6 billion for a 25%-to-35% stake in Telefónica Internacional (Tisa), the subsidiary through which Telefónica has been making its bold moves. Insiders at Telefónica say GTE has the edge and is close to clinching an agreement, but AT&T or others could still join. "Our only condition is to keep a majority stake," says Telefónica Internacional CEO Ignacio Santillana. GTE and AT&T will say only that they are talking to Telefónica on a range of issues.

EXPLODING DEMAND. Much of Telefónica's new luster comes from its moves in Latin America. In 1988, when political instability kept North American rivals on the sidelines, Tisa pounced. Now, demand for phone service is exploding, making Telefónica's \$3.5 billion investment look like a coup. "They have turned huge money-losers to profit in a very short time," says Joshua Levenberg, an analyst at Pyramid Research Inc. in Cam-

bridge, Mass. Tisa's first-quarter profits this year rose 89%, to \$30 million, and analysts are forecasting profit growth of 20% a year well into the next decade. "You're not buying a Peruvian telephone company for the business it has today. You're buying it for the business it will have by 2001," adds Tom Will, president of Miami-based consultancy Intercom Corp.

The potential alliance between Telefónica and GTE, the world's fourth-largest phone operator, also could be a coup.



TELEFONICA DE ESPANA EXTENDS ITS REACH

PERU \$2.02 billion bid for 85% stake in ENTEL and CPT, the Peruvian national phone operators.

PUERTO RICO Paid \$142 million for a 79% stake in TLD, the long-distance operator, gaining it a possible entry point into the U.S. market.

CHILE Owns 43.7% stake in CTC, operator of 95% of local networks and 30% of ENTEL-Chile, the main long-distance operator.

ARGENTINA Leads a consortium that owns a 60% stake in TASA, one of two common carriers.

VENEZUELA Owns 16% of a consortium that has a 40% controlling stake in the CANTV, a phone operator.

URUGUAY Has 10% stake in the cellular operator Teco Tasa as part of a consortium led by TASA.

In the next five years, GTE wants to double the 11% of its sales generated outside the U.S. Telefónica, in turn, would extend its reach in Latin America, thanks to GTE's controlling position in Venezuelan phone operator CANTV and mobile licenses in Argentina. The link would also bring Telefónica fresh capital and innovative technology. "We need a partner to help confront competition in new technologies," says Santillana. The two companies would also be a powerful team for bidding in Brazil, the "largest opportunity on the horizon," according to GTE Vice-Chairman Michael T. Masin.

AT&T could benefit from a GTE-Telefónica link, too. Telefónica has a 25% stake in Unisource, a Dutch-Swiss-Swedish network consortium that caters to multinationals. Unisource, in turn, has a stake in WorldSource, AT&T's network consortium for multinationals. Wrap together a Unisource-AT&T-Telefónica-GTE partnership, and there's potential for an unmatched globe-spanning telecommunications network.

DEADLINE RUSH. For now, Tisa has plenty on its plate. Having won the Peru bid, Santillana is looking for ways to refinance \$1 billion in bridge loans. And Telefónica is gearing up for big changes in its home market—one of the most protected in Europe. In June, Spanish officials announced that they now would be willing to meet the 1993 European Union deadline for allowing competition in phone service, even though Spain, along with Ireland and Greece, won the European Union's permission last year to retain its monopoly until 2003. Telefónica Chairman Candido Valazquez says he is prepared to sacrifice the phone monopoly in exchange for being allowed to enter new businesses, particularly cable TV.

New business will require some fresh capital, as will Telefónica's overseas buying spree, which has continued recently with Latin American cable-TV deals. So an alliance with a deep-pocketed partner would be particularly timely. Santillana says that he isn't worried, though. The big U.S. phone companies gave him the cold shoulder four years ago when he wanted to join in his Latin American push. But this time, he notes with satisfaction, it's his turn to keep would-be allies waiting for the phones to ring.

By Gail Edmondson in Paris, with Tim Smart in Stamford, Conn., and a bureau reports



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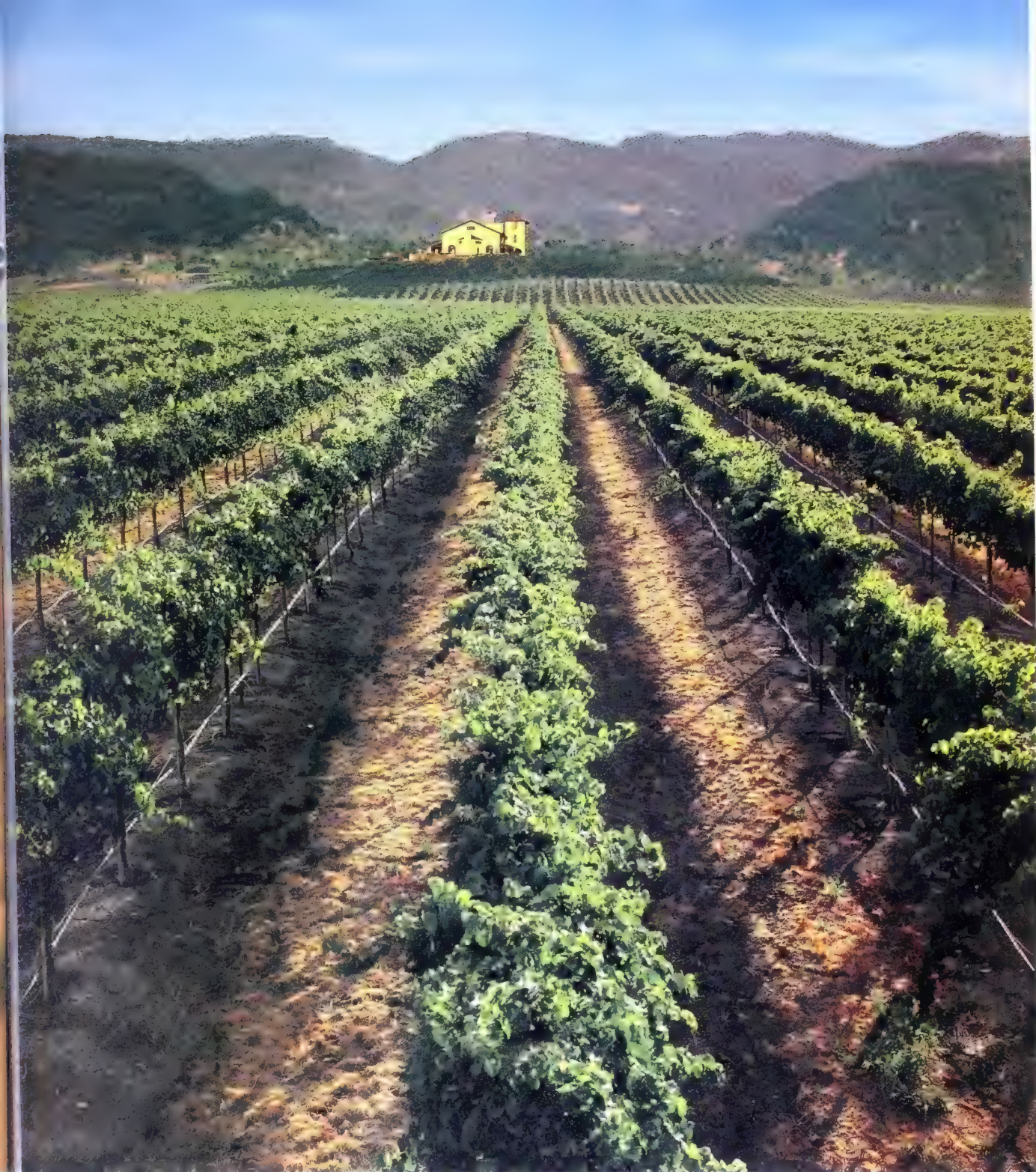
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A SPORTS MARKETER WITH A MEAN CURVE

In a rapidly growing field, Clarion is No. 2 and trying harder

After Sprint Corp. paid \$20 million in sponsorship fees for the 1994 World Cup, Mike Goff needed help. As director of corporate sponsorships, Goff wanted Sprint to get its money's worth. So for a flat fee, he hired a sports-marketing firm, Clarion Performance Properties in Greenwich, Conn., to come up with ideas.

The result: long-distance calling cards picturing soccer stars, a geography program for Latin American schools tied to game results, and discounts on long-distance calls for soccer-related businesses. Plus, Sprint agreed to pay a percentage of soccer-related long-distance bills to local soccer groups. And every World Cup fax or phone call went through Sprint. A preliminary analysis of how much business the programs produced, Goff says, is "frankly, stunning. We owe a lot of our success to Clarion."

Sports marketers help corporations sponsor everything from rodeos to the Olympics, and Sprint's success isn't rare. National Association for Stock Car Auto Racing (NASCAR) sponsors see as much as a 1,000% return on their money in increased sales and brand recognition, says a study by a group of Wake Forest University MBA students. Valvoline Inc. pays about \$3.5 million yearly in NASCAR sponsorships but gets \$22.4 million in sales and exposure in return, the group figured, assessing value to such factors as the number of minutes the Valvoline name is on TV screens during races.

The sports-marketing business is seeing phenomenal growth: Companies paid \$2.4 billion last year in sports-related ventures, up 15% from 1992, mostly filtered through sports marketers. But Clarion is becoming a particularly heavy hitter. For Indianapolis Motor Speedway, Clarion negotiated \$22.5 million worth of contracts with Budweiser, Chevrolet, Delco Electronics, Pennzoil, and General Mo-

tors Service Parts Operations to sponsor the Brickyard 400, NASCAR's successful debut for stock cars at the once-exclusive home of the Indy 500.

Clarion was recently picked by H. Wayne Huizenga's Blockbuster Entertainment Corp. to combine promos for video-rental customers and fans of his



FORMER P&G TEAMMATES KANE AND NIEROTH

Miami Dolphins football team, Florida Panthers hockey team, and Florida Marlins baseball club. For example, customers of South Florida Blockbuster stores who rented three videos this summer got a pass to a Marlins game.

Clarion also controls marketing for National Football League Properties Inc.,

the \$2.5 billion merchandise-marketing arm of pro football. When Clarion took over in 1987, the average price paid by a company wanting to become an NFL sponsor—the "official" soft drink, or whatever—was \$500,000. Now, it's \$10 million. Clarion's "position and ability to execute their plans has made them quite successful," says Alan Friedman, editor of *Team Marketing Report*, an industry newsletter.

Credit Alex Nieroth and Gordon H. Kane, two former Procter & Gamble Co. brand managers who run Clarion, a division of New York ad agency D'Arcy Masius, Benton & Bowles Inc., which bought it in 1989. Sports marketing once meant hanging banners in stadiums, and even now, it's often little more. But Nieroth and Kane take a strategic, brand development approach they learned in their P&G days. Kane, 36, says that too often businesses sponsor sport for the wrong reasons. In the past, this sometimes happened because CEO or CFO "had a great affinity for the sport."

HIGHER PROFILE. That's changing thanks to sports marketers that show companies how to use sports to grab potential customers' attention. Cleveland-based International Management Group (IMG), which also represents athletes and owns sporting events, dominates the field and is Clarion's biggest competitor. Other rivals include Stamford (Conn.)-based Sport & Co., which specializes in pro bicycle races, and Switzerland's ISL Marketing, which represents the Olympic Games. Clarion, founded in 1987, ranks second to IMG—a \$700 million company that doesn't break out sports-marketing results—with \$30 million in revenue, and has been raising its profile lately with marquee customers.

Nieroth's team created the Gillette promotion in which one fan is picked to shoot a three-pointer for \$1 million in the NCAA basketball championship. This year, 2 million fans—who had to buy a Gillette product to enter—signed up.

But sports can toss beanballs at marketers. Clarion thought it was a competition for Gillette in which one fan will try to throw a baseball into a catcher's glove at the World Series. Oops! When the players' strike meant that event may not see an October night, Nieroth figures Clarion has already hit the mitt.

By Chris Roush
Greenwich, Conn.

PAGES FROM CLARION'S PLAYBOOK

BLOCKBUSTER To leverage video-game rentals, the fastest-growing segment of Blockbuster's business, Clarion developed a world video-game championship that was held on Aug. 21 in Fort Lauderdale, Fla.

NFL PROPERTIES Clarion has helped expand golf outings involving NFL stars and golf pros to four events per year.

GILLETTE Clarion thought of having a fan shoot a three-pointer for \$1 million at the NCAA Final Four. A \$1 million World Cup soccer kick contest was a natural.

capability: executive programs

RIDE THE TECHNOLOGY REVOLUTION

Illustration by Victoria Kann. As seen in BusinessWeek, May 23, 1994 Issue.

The Information Revolution

The Technology/Business Interface

Date: Monday and Tuesday, October 31 - November 1, 1994

Place: McGraw-Hill World Headquarters, New York City

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CAN YOUR FUND PASS THESE SECURITY CHECKS?

The mutual-fund industry, long praised for remaining scandal-free, this year has been plagued with bad publicity. Portfolio managers have been called to task for conflicts of interest and investing in risky securities that generated startling losses. Some fund sponsors were reprimanded for misleading advertising and for errors in reporting prices and allocating trades. This steady stream of bad news is disquieting for investors who may be realizing mutual funds aren't immune from ethical breaches.

HAND-WRINGING. But if you're starting to wonder if you can trust your mutual fund, a wealth of information is available to help you assess your holdings. Keep in mind that regulations governing funds allow little opportunity for outright fraud and—although funds can lose money—it is virtually impossible for them to go bankrupt the same way a company can. Fund sponsors have responded swiftly to squelch improprieties and regulators are expected to beef up their monitoring apparatus, which they admit has not kept pace with industry growth. Even the trade group, the Investment Company Institute (ICI), has pushed for tougher rules and more regulatory oversight, realizing that a few rotten funds could spoil the whole barrel.

So far, investors in funds that have run into trouble have emerged relatively unscathed. For example, much of the concern over conflicts

of interest was touched off when Invesco Funds Group fired one of its star managers, John Kaweske, in January for failing to comply with its personal trading rules. The ICI responded by creating a panel that recommended

funds run by BankAmerica, Fleet Financial, and others lost money due to use of inappropriate derivative securities, the companies bailed out the funds so investors wouldn't suffer losses. The Securities & Exchange Commission followed

largely due to investments in collateralized mortgage obligations and securities derived from them. But the fact that this fund contained mortgage-backed securities was well known. The fund enjoyed twice as high a return last

year as many of its competitors—a red flag that its manager was taking extra risks. As a show of confidence, Piper Jaffray invested \$10 million in the fund in May and then closed it to new investors so existing ones could benefit from any share price improvement. The company also ran a letter from its chairman in some newspapers responding to criticism, and listed a toll-free number to call for further explanation.

COMING CRISIS? There are other problems that have been important for industry professionals and regulators to tussle with. But even if the implications for individual investors have been minimal, that's not to say there won't be more problems down the line. Fund managers are getting more speculative, and sponsors more aggressive, says Donald Christensen, author of *Surviving the Coming Mutual Fund Crisis* (\$22.95, Little, Brown and Co.). As scandals inevitably erupt, investors will grow disillusioned, abandoning mutual funds, he says. Despite his doomsday view, Christensen admits: "You can be in mutual funds and survive what I consider to be a crisis."

To improve your chances, you need to be vigilant about the funds you pick. That



THE FUND INDUSTRY has been largely scandal-free so far, but keeping close watch may become de rigueur for the investor

tougher rules, and companies gladly agreed to step up compliance. Despite the hand-wringing over Kaweske's trading, investors in Invesco Industrial Income, the fund he managed, can boast a 10-year average annual return of 16.8% through July.

And, while money-market

up by warning all money-market funds to stay away from exotic derivative holdings.

Even the latest high-profile fund fiasco is not as frightening as it seems. Piper Jaffray's Institutional Government Income Portfolio, which has a \$25,000 minimum, has fallen 23.5% this year through July,

means following advice you've been hearing for years: Know the manager, understand the investment strategy, don't take more risk than you can handle. Review your choices at least once a year to make sure the management or strategy is not changed.

Indeed, some funds have gotten riskier as the financial world has grown more complex and competitive. For example, an aggressive fund you bought three years ago may be purchasing illiquid securities such as private placements, Third World debt, or mortgage derivatives. Or it may be using leverage or commodity futures.

W BREEDS. Some funds, such as American Heritage and Robertson Stephens Contrarian, have gotten so speculative that in a recent editorial, *Morningstar Mutual Funds* led on the industry to distinguish them from the rest of the mutual fund world. "Investments that didn't even exist a few years ago, or ones that historically have been the domain of hedge funds or venture-capital pools, are finding their way into the portfolios of mainstream America," *Morningstar* warns.

The derivative losses in new money-market and short-term bond funds show that even conservative funds may invest in untested securities. For the past 10 years, the fixed-income fund arena has been a graveyard of failed contracts, including option-indexed funds, government funds, and multimarket funds, says Don Phillips, *Morningstar's* publisher. Choose funds that employ tried-and-true strategies and have at least a five-year track record.

If a fund has exceeded your comfort level for a while, you may want to gradually shift into a more conservative offering. But don't panic or you may be at the worst time. Illiquid investments can

FERRETING OUT PROBLEMS IN MUTUAL FUNDS

- ▶ Has the fund company been the subject of negative publicity that makes you question its integrity? How did the company respond?
- ▶ Did the advertising prove to be misleading once you reviewed the fund's investment strategy, fees, and past performance?
- ▶ Does the fund invest in illiquid securities, such as mortgage derivatives, restricted stocks, or debt of Third World countries?
- ▶ Does the prospectus allow the fund to engage in any speculative trading practices, such as those employing futures or options, buying on margin, or short-selling? If allowed, does the fund do such things?
- ▶ Is the fund company asking permission to raise its fees or expenses or to use riskier investment strategies? Watch the proxy statements.
- ▶ Is the fund's performance consistent with similar funds? If your fund is a stellar performer, make sure it's not taking undue risks.

DATA. BUSINESS WEEK

cause the share price to jump around. But that doesn't mean they won't pay off handsomely for investors who can tolerate the volatility. By sticking with plain-vanilla funds, you may miss out on some of the more rewarding investments managers have discovered.

You can get a snapshot of the holdings by reviewing the annual and semiannual reports, but the funds don't make it easy: You won't find the word "derivative" used, and judging securities listed as "collateralized notes" or "indexed securities" is too tough for anyone

but the pros. The investment summary and market performance analysis in these reports often will be more useful.

The fund's prospectus includes an investment policy statement, which outlines the overall strategy, lists what the fund can and cannot do, and highlights specific risks. But even if the prospectus says the fund can sell short or use commodity futures, you'll have to ask the company if it really intends to do such things. For legal reasons, charters of new funds may allow them to engage in virtually all invest-

ment practices, even ones the fund has no intention of using, says Phillips. Many funds ask shareholders to approve changes to their charter, allowing them to make more speculative trades. Review proxy statements to be sure the fund company isn't trying to change the bylaws, letting the manager use riskier strategies.

If you don't want to wade through all those documents, performance can offer an important clue about the manager's course. If your fund is returning substantially more than its peers, it is

probably taking on more risk. Conversely, if a fund has declined much more than others in its category, it may be getting punished for speculating.

THE RIGHT STUFF. Individuals should make sure they have faith in the integrity of the fund company. Complicated fee structures and misleading advertising can be signs that the fund is overly hungry for investor dollars. If a fund you own is the subject of negative publicity, watch to see if the company responds swiftly to accusations.

When it all boils down, there is an element of trust involved in mutual-fund investing. If you're worried about your holdings now, you might wish to choose a portfolio manager who has weathered a bear market. Another way is to deal only with large, reputable companies such as Fidelity, Vanguard, and Dreyfus.

All the scrutiny that mutual funds are getting from the industry, regulators, and the media should be reassuring. "On the whole, this is a healthy process," says Phillips. "In the end it uncovers more useful information for investors." Now that you know some of the things that can go wrong, use the information to make certain the funds you buy don't veer too far off course. *Amey Stone*

SOME HIGH-PROFILE FUND FOIBLES

JANUARY 1994 Invesco fired one of its star managers for failing to comply with its rules on personal trades, setting off an industrywide effort to toughen compliance systems.

MAY The head of Pilgrim Group was disciplined by the National Association of Securities Dealers for misleading advertising.

MAY Piper Jaffray's Institutional Government Income Portfolio fell 24% because of losses in mortgage derivatives. Piper invested \$10 million in the fund as a show of confidence.

JUNE Fidelity Investments reported incorrect share prices on its mutual funds after a day when most funds dropped in value. Fidelity apologized, and the deadline for reporting prices was extended.

JUNE AND JULY BankAmerica spent about \$68 million to bail out two money-market funds that lost money because of derivatives trading. Other fund groups made similar moves to protect shareholders.

JULY Strong/Corneliusson Capital Management settled regulators' complaint over pricing problems and trading between funds from 1987 to 1990. Strong agreed to reimburse funds for pricing errors.

DATA. BUSINESS WEEK

Music

TUNING KIDS IN TO HAYDN AND BACH

September, Congress has declared, is Classical Music Month. In that spirit, you can help create a crescendo for Beethoven, Bach & Co. with a slew of new products that teach children about classical music. The offerings go far beyond the *Peter and the Wolf* records you probably learned from—though *Peter* lives on in new versions.

You might start with two tape-and-book packages for kids 4 and up: In Astor Books' *Looney Tunes Special Delivery Symphony* (\$7.98), kids follow Bugs Bunny in an amusing story that introduces the orchestral instruments. Astor's *Donald's Wild Adventure* (\$8.98)—in which Donald Duck visits a haunted house—discusses the instruments to Saint-Saëns' *Danse Macabre*, among other pieces. But it's flawed: The tape doesn't match the book exactly.

Tubby the Tuba, played by Manhattan Transfer in a Koch International CD, engages children in three tales that introduce the orchestra (plus one about a jazz band). By showing Tubby's misguided yen to be glamorous, the stories teach the lesson "be yourself." (All CDs mentioned cost around \$15, all cassettes about \$9.)

ZOO SUITS. Young kids will delight in videotapes that use Jim Gamble's puppetry: *Peter and the Wolf*, *The Nutcracker*, *The Adventures of Peer Gynt*, and *Carnival of the Animals* (\$14.95, Bogner Entertainment). In *Peter*, children work with composer Prokofiev to use instruments to portray bird, the cat, and others. *Carnival* relates how Saint-Saëns composed the piece as a child when his mother wouldn't let him go to the carnival because he did his homework. In *Peter*, with Gamble: *Hansel and Gretel*, the operetta.

Older children are more likely to tune into two of those stories on a brand-new *Peter and the Wolf* CD (Sony Classical). Clarissa, star of Nickelodeon's top comedy, narrates *Peter and Carnival* in updated fashion—inviting listeners to imagine *Carnival* as the greatest-ever visit to a zoo. This CD also contains Britten's *The Young Person's Guide to the Orchestra*, again with hip comments on instruments and musical variations. Clarissa's basic message: "Classical is cool."

Peter Ustinov proves a fine

The latest offering from makers of the phenomenally successful *Beethoven Lives Upstairs* (The Children's Group)—a recording that became a video, a live show, and a book—is *Tchaikovsky Discovers America*. Like *Beethoven* and sister products on Bach, Vivaldi, and Mozart, *Tchaikovsky's* story blends fact, fantasy, and music. The composer, in New York to open Carnegie Hall, is rescued from reporters by Russian émigrés and taken to Niagara Falls. *Tchaikovsky*, now only in audio, debuts in video

G'Night Wolfgang, *G'Morning Johann*, and *Hey, Ludwig* (Music for Little People). And there's *The Classical Child*, Vols. I, II, III, and IV, with selections from Bach, Haydn, and others (Metro Music). But none offers anything beyond the music itself to hold a child's attention. Come winter, look for a similar product, with a gimmick: *Snoopy's Classical Classics on Toys* (Lightyear Entertainment) plays the masters on toy instruments.

In contrast, *The House of Magical Sounds* (\$24.95, Sony Classical) is an ambitious video due in October. It begins by telling how conductor Claudio Abbado resolved at age 7 to have a music career and ends up teaching about the orchestra, conducting, composition, and opera. Mixing animation and real performances, it's sophisticated and assumes knowledge of World War II, for example. It's well done, and full of information that it stands up for many viewings.

MASTER WORKS. Also series are 18 recordings narrating the lives, with musical selections, of the masters, typified by *The Story of Chopin* (Vox Music Group). These are excellent products—for older children.

High tech really hasn't gone musical. Microsoft sells CD-ROMs on composers (Beethoven, Stravinsky, Mozart among them), but they're pitched at adults. Coming in September is the "maestro" edition of *Music Mentor* (\$49.95, Midisc). It goes beyond the music theory and history in the first edition, adding a composers' gallery and allowing users to orchestrate a concert and put tunes on various instruments.

Perhaps the most all-encompassing music product is a book, sort of: *The Music Factory* (\$50, Knopf), due in November. It's a pop-up, pull-out read-and-do package that lets owners discover the development of music, make scale models of instruments, and how music is recorded, among much more. It includes all of 20 masterpieces, and it's a sensational way to tune into classical music.

Judith Dobry

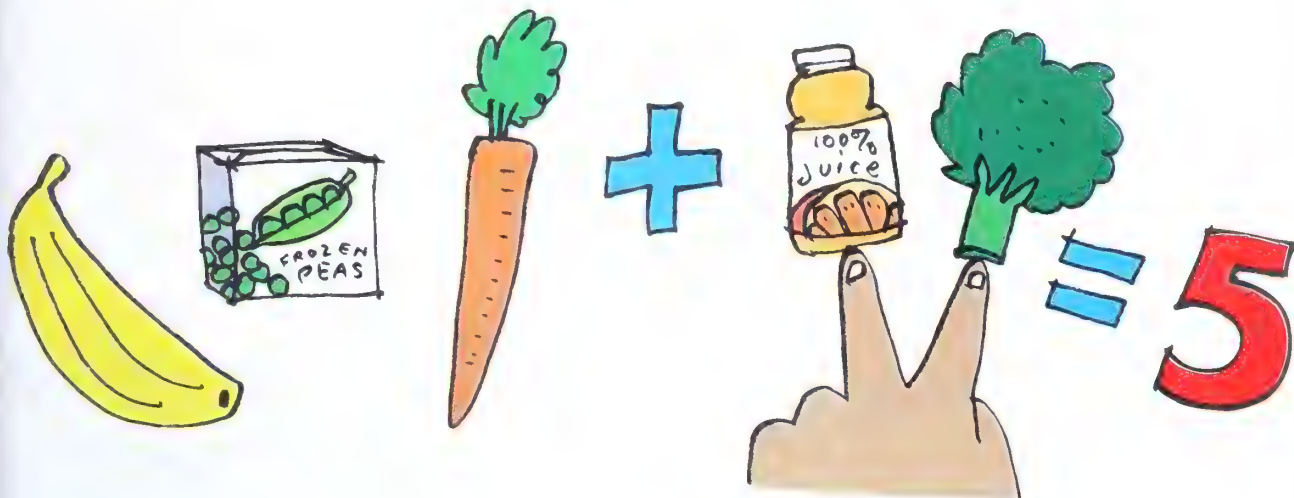


narrator in *The Orchestra* (Mark Rubin Productions/Alcazar), in both recording and video (\$18.98). It delivers much more than its title suggests: It calls up excerpts to show how music can make people feel sad, silly, serious, and so on. It tells how a composer writes music. It explains harmony, rhythm, and tempo. And its playful treatment of music, in the video, is accompanied by charming animation.

next spring (\$19.98), followed by a Mozart video and a new audio tape about Handel.

Once you've kindled an interest in classical music, producers offer several recordings "designed" for kids. There's *Schroeder's Greatest Hits* (including Beethoven's *Moonlight Sonata*), *Cartoon Classics* (including *The Sleeping Beauty Waltz*), and *Tchaikovsky: The Children's Album* (RCA Victor/BMG Classics). There's

3's a great start. The next 2 are easy!



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Most of us already eat 3 servings of fruits and vegetables every day, according to surveys for the National Cancer Institute's 5 A Day program. That's more than halfway to the recommended "5 A Day For Better Health." So go for 2 more — eating at least 5 A Day is easy:

1

Get off to a running start with a 6 oz. glass of 100 percent juice and a bowl of cereal topped with berries or banana slices. That's 2 servings — and the day's just begun...

2

Bring a bag of cut-up, "snackable" vegetables like carrot, celery and cucumber sticks to quiet the mid-morning growl, which adds another easy serving — works great for kids, too...

3

Create a salad for lunch — that's at least one or two servings. Be sure to choose a low-fat dressing. Now you're up to at least 4 servings...

4

Crunch into that apple you've been eyeing all day, or dig into a bag of dried apricots for those afternoon hunger pangs. For kids, offer little boxes of sweet, chewy raisins as a tasty afterschool treat. That's 5, but don't stop yet — you're on a roll...

5

Pop a potato into the microwave at the end of a hectic day, and top it with salsa to add a healthy, zesty punch. Or try stir-frying broccoli, red and green peppers, mushrooms, and peas together into a quick dish.

Wasn't that easy? You've just breezed through more than 5 A Day. Fruits and vegetables are easy to fix and eat. From fresh to frozen, dried to canned... stir-fried, steamed, squeezed, microwaved, or as is... wherever you are, keep them in sight and top of mind.



Seems as if every auto maker is crowding into the value end of the luxury class, where cars go for roughly \$30,000. While Mercedes-Benz recently swooped down from the stratosphere with its C-class, three new flagship models from Oldsmobile, Mazda, and Buick are stretching upward. Although they don't match the luxury and performance of cars such as the nearly \$60,000 BMW 740i or the \$52,000-plus Lexus LS400, they come mighty close for a lot less money.

Autos

LUXURY'S HIGH ROAD—WITH LOW-END PRICE TAGS

jumping from 0 to 60 mph in just eight seconds. Among competing cars, only the BMW 325i is quicker. That's an amazing feat, given the Millenia's small engine—a 2.5-liter V-6. On the down side, it lacks the high-speed oomph for confident passing. The Au-

trim. The Aurora has standard leather seats with great back, side, and thigh support. Both cars have ample leg- and headroom up front. But the swooping roof lines may have tall rear-seat passengers bumping their heads.

Behind the wheel, the Auro-

starkly unadorned instrument panel are large and clearly marked. The turn-signal stalk, however, is overloaded with hard-to-see cruise-control and windshield-wiper switches.

In this group, the Aurora with its V-8 engine and its set of standard features, stands out as a good value. Even fully loaded, it runs \$34,400, the same price as a top-of-the-line Millenia S. There's also an entry-level Millenia, starting at \$26,400, but its 170-hp engine leaves the car underpowered. For sportier luxury, check



THE \$28,300 BUICK RIVIERA: A CLASSIC COUPE THAT FLOATS OVER POTHOLES



AT \$32,400, THE MAZDA MILLENIA S JUMPS TO A FAST START: 0 TO 60 IN EIGHT SECONDS



THE OLDSMOBILE AURORA: CUSHY RIDE, POWER, FLASH, AND A \$32,000 STEEL

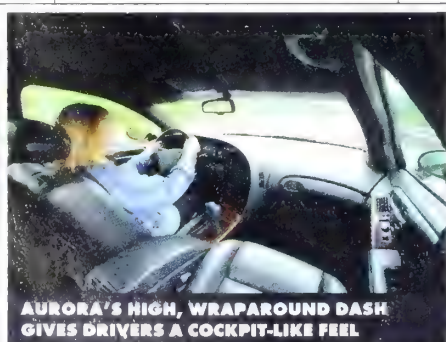
Two of the newcomers, the Olds Aurora and Mazda Millenia S, are rival sedans that offer the convenience of four doors yet have a dose of style. The Buick Riviera, meanwhile, is a traditional American coupe aimed at consumers who prize aesthetics over high performance. All three boast the quiet ride and convenient features you would expect in this class. Each, however, is marred by annoying flaws.

HEAD-TURNER. Beauty is subjective, but the Aurora, with a \$32,000 base price, is the clear head-turner in this group. Its swooping roof and muscular stance are miles from the stodgy lines of your father's Oldsmobile. In fact, many people initially think it's a Japanese model. Likewise, the \$28,300 Riviera's curvy, sculpted shape has a decidedly international flavor. The more traditional, \$32,400 Millenia S stands out less from the automotive clutter.

The Aurora and Millenia both have a kick to drive, if you push them hard. The Millenia accelerates vigorously,

but the Aurora is a tad slower at reaching 60 mph, even with a 4-liter V-8. Blame its beefy 4,000 pounds. But there's plenty of reserve power for passing.

When it comes to ride, the Aurora is the cushier sedan. On really rough pavement,



AURORA'S HIGH, WRAPAROUND DASH GIVES DRIVERS A COCKPIT-LIKE FEEL

however, the Aurora pitches and rolls more than the Millenia, whose taut suspension controls body motion better. In hard cornering, the Aurora leans noticeably, but the car handles with confidence-inspiring poise. The Millenia responds with a sportier feel, diving quickly into turns and whipping out with precision.

Both cars pamper passengers with nifty features such as power seats, automatic climate control, and real wood

trim. The Aurora has standard leather seats with great back, side, and thigh support. Both cars have ample leg- and headroom up front. But the swooping roof lines may have tall rear-seat passengers bumping their heads.

Behind the wheel, the Aurora has a dramatic, cockpit-like feel. The instrument panel curves toward the driver, and the controls fall easily to hand. But some drivers may find the high, wraparound dash claustrophobic. Most troubling, the radically curved back window badly distorts rear vision. The Millenia's more traditional dash layout gives an open feel and expansive view of the road ahead. Controls such as radio dials are large and easy to use. But some drivers may find other switches hard to locate, notably the cruise control and window defogger—both behind the wheel.

The Riviera should appeal to more sedate drivers willing to accept the limitations of two doors. Its base 205-horsepower V-6 launches the Riv to 60 mph in a more leisurely 10 seconds. A supercharged version, though, which costs \$1,100 more, is nearly as quick as the Aurora. The Riviera's spongy suspension floats over potholes, but it won't inspire drivers to race around corners. The car shares the Aurora's comfy front seats and tall dash. Most dials on the

under \$32,000 BMW 325i for more cachet, the \$38,000 Mercedes C280. The Riviera competes most directly with traditional luxury coupes such as the \$38,800 Lincoln Continental VIII and the \$38,220 Cadillac Eldorado—both equipped with V-8s. Even in the traffic of fine, value-priced luxury cars already on the road, the trio certainly holds its own.

Kathleen Kerwin and her Woodruff

Worth Noting

■ **SCHOOL BUCKS.** High school seniors about to apply for college can get information on obtaining financial aid in a free brochure, *Steps to Success*. You can order a free copy from Nellie Mae, the leading nonprofit student loan provider (800 9-TUITION).

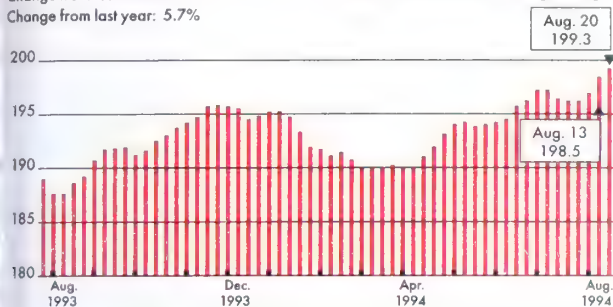
■ **ARNIE'S TOUR.** A new CD-ROM, *The American Golf Course Presented by Arnold Palmer*, provides multimedia tours of more than 11,500 of the most challenging U.S. courses on disk, which will be available in September from Data Design Software (717 652-4344) for \$59.95.

Business Week Index

PRODUCTION

Change from last week: 0.4%
Change from last year: 5.7%

1967=100 (four-week moving average)

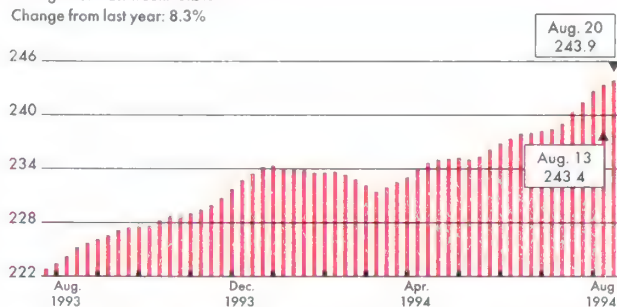


The production index increased during the week ended Aug. 20. On a seasonally adjusted basis, production for steel, paperboard, and paper rose, while truck, coal, and lumber output, as well as rail-freight traffic, declined. Electric power, crude-oil refining, and auto production levels were unchanged from their levels of the previous week. Before calculation of the four-week moving average, the index slipped to 199.8, from 199.9 in the prior week.

BW production index copyright 1994 by McGraw-Hill Inc

LEADING

Change from last week: 0.2%
Change from last year: 8.3%



The leading index increased slightly during the week ended Aug. 20. A hike in short-term interest rates by the Federal Reserve Board touched off rallies in the stock and bond markets, while the growth rates for materials prices, real estate loans, and M2 all picked up steam. Data for large-business failures were unavailable for the latest week. Before calculation of the four-week moving average, the index rose to 244.9, from 243.4.

Leading index copyright 1994 by Center for International Business Cycle Research

PRODUCTION INDICATORS

	Latest week	Week ago	% Change year ago
STEEL (8/27) thous. of net tons	1,858	1,809#	0.1
TRUCKS (8/27) units	116,719	126,754r#	18.3
TRUCKS (8/27) units	110,501	122,359r#	21.7
ELECTRIC POWER (8/27) millions of kilowatt-hours	67,213	67,975#	-4.4
CRUDE-OIL REFINING (8/27) thous. of bbl./day	14,415	14,355#	3.5
STEEL (8/20) thous. of net tons	20,435#	20,393	13.6
PAPERBOARD (8/20) thous. of tons	886.8#	884.1r	8.1
PAPER (8/20) thous. of tons	841.0#	838.0r	4.2
COAL (8/20) millions of ft.	472.8#	478.1	3.7
RAIL FREIGHT (8/20) billions of ton-miles	24.3#	24.2	12.5

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., American Paper Institute, WWPAA, SFPAA, Association of American Railroads

FOREIGN EXCHANGE

	Latest week	Week ago	Year ago
JAPANESE YEN (8/31)	100	98	105
GERMAN MARK (8/31)	1.58	1.54	1.65
BRITISH POUND (8/31)	1.54	1.55	1.50
SWISS FRANC (8/31)	5.41	5.29	5.81
CANADIAN DOLLAR (8/31)	1.37	1.38	1.32
U.S. DOLLAR (8/31)	1.33	1.30	1.45
MEXICAN PESO (8/31)	3.387	3.342	3.106

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British and expressed in dollars

RICES

	Latest week	Week ago	% Change year ago
WHEAT (8/31) \$/troy oz.	385.750	383.900	4.5
WHEAT SCRAP (8/30) #1 heavy, \$/ton	134.50	134.50	19.6
WHEAT STUFFS (8/30) index, 1967=100	213.2	214.6	0.9
CORN (8/27) ¢/lb.	113.3	112.9	24.2
SOYBEAN (8/27) ¢/lb.	72.0	71.0	34.0
WHEAT (8/27) #2 hard, \$/bu.	3.81	3.73	14.1
WHEAT (8/27) strict low middling 1-1/16 in., ¢/lb.	70.26	68.06	32.9

Sources: London Wednesday final setting, Chicago market, Knight-Ridder Commodity Research, Metals Week, Kansas City market, Memphis market

LEADING INDICATORS

	Latest week	Week ago	% Change year ago
STOCK PRICES (8/26) S&P 500	467.55	463.63	1.8
CORPORATE BOND YIELD, Aaa (8/26)	8.13%	8.07%	21.2
INDUSTRIAL MATERIALS PRICES (8/26)	106.3	105.9	11.4
BUSINESS FAILURES (8/19)	NA	317	NA
REAL ESTATE LOANS (8/17) billions	\$436.5	\$435.9r	5.6
MONEY SUPPLY, M2 (8/15) billions	\$3,560.5	\$3,554.5r	2.0
INITIAL CLAIMS, UNEMPLOYMENT (8/13) thous.	325	325r	0.3

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of large companies), Federal Reserve, Labor Dept. CIBC seasonally adjusts data on business failures and real estate loans

MONTHLY ECONOMIC INDICATORS

	Latest month	Month ago	% Change year ago
PERSONAL INCOME (July) annual rate, billions	\$5,692.9	\$5,663.0r	6.3
CONSUMER SPENDING (July) billions	\$4,620.2	\$4,612.5r	5.4
NEW HOME SALES (July) annual rate, thous.	664	613	2.6
11 LEADING INDICATORS COMPOSITE (July) index	101.5	101.5	3.7

Sources: Commerce Dept.

MONETARY INDICATORS

	Latest week	Week ago	% Change year ago
MONEY SUPPLY, M1 (8/15)	\$1,148.2	\$1,147.8r	4.9
BANKS' BUSINESS LOANS (8/17)	301.2	300.0r	10.1
FREE RESERVES (8/17)	487	887r	52.7
NONFINANCIAL COMMERCIAL PAPER (8/17)	150.1	150.5	-6.3

Sources: Federal Reserve (in billions, except for free reserves, which are expressed for a two-week period in millions)

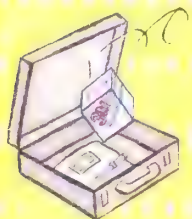
MONEY MARKET RATES

	Latest week	Week ago	Year ago
FEDERAL FUNDS (8/30)	4.67%	4.64%	3.08%
PRIME (8/31)	7.75	7.75	6.00
COMMERCIAL PAPER 3-MONTH (8/31)	4.91	4.91	3.17
CERTIFICATES OF DEPOSIT 3-MONTH (8/31)	4.89	4.87	3.13
EURODOLLAR 3-MONTH (8/26)	4.86	4.85	3.13

Sources: Federal Reserve, First Boston

W data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment. #Southern Forest Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

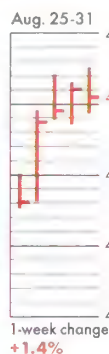
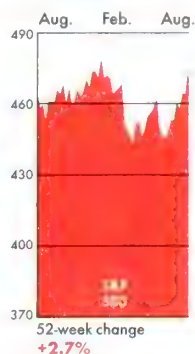
A	ABB Asea Brown Boveri 72 ABC 42 Air France 46 Alcazar 100 American Express 33 American Heritage 98 AMG Data Services 33 Apollo Advisors 83 Apple Computer 88 Archer Daniels Midland 70 Arco 70 Astor Books 100 AT&T 34, 70, 83, 88, 90	Eastman Kodak 30, 35 Eddie Bauer 74 EDS Management Consulting 34 Electronic Data Systems 90 Eli Lilly 30 Emerson Electric 30 Entergy 70 Eo 88 E Style 74	Levin-VHI 60 Lightyear Entertainment 100 Little Brown 98 Lockheed 30, 32 Logicom 88 Loral 32, 70	Revlon 6, 70 Riordan & McKinzie 12 Riordan, Lewis & Hayden 12 Robertson Stephens Contrarian Fund 98
B	BankAmerica 30, 98 Barrington Associates 74 Bastion Capital 83 Bayer 35 Beacon Hill Financial 83 Beekman Capital Management 80 Bell Atlantic 70 BellSouth 88 Bertelsmann 52 Blackstone Group 83 Blockbuster Entertainment 96 BMG Classics 100 BMW 102 Boeing 32, 54, 70 Bogner Entertainment 100 Borland International 46 Budweiser 96	F Federal Reserve Bank of Kansas City 60 First Chicago 60 Fleet Financial 98 Fleming 30 Forrester Research 88 Forstmann Little 83 Foster Wheeler 72 Fox 42 Fujitsu 46 Futures Group 60	M Mabon Securities 90 Marion Merrell Dow 35 Mark Rubin Productions 100 Martin Marietta 30, 32 Mason & Hanger 78 MCA 42 McCaw Cellular Communications 34 McDonnell 32 McGraw-Hill 28 MCI Communications 34, 90 Medical Data International 76 Mehta & Isaly 46 Mercedes-Benz 102 Mercer Management Consulting 34 Merck 30, 35 Merrill Lynch 33, 60, 86 Metromedia 90 Metro Music 100 Microsoft 88 Midisoft 100 Mitsubishi 72 Mitsubishi Bank 26 MMS International 28 Montgomery Ward 74 Morgan Stanley 54, 60 Motorola 20, 72, 88 Music for Little People 100	S Sacramento Theatre 60 SCI Capital Management 26 Scott Paper 46 Scrivner 30 Seagram 86 Securities Data 30, 33 Sharp 88 Sharper Image 74 Siemens 72 Sigma Designs 78 Silver Investment Advisor Research 86 Singer 12 Six Flags 83 Sky Broadcasting 52 Smith Barney Shearson 8 SmithKline Beecham 30 Snapple Beverage 84 Sony 40, 42, 88, 100 Sound Scan 40 Spiegel 74 Sports & Co. 96 Sprint 90, 96 Standard Chartered Securities 54 Stephen Wolf 46 Sterling-Winthrop 35 Storage Technology 86
C	Canal+ 52 Cap Cities 42 Catalog 1 74 CBS 40, 42 Chevrolet 96 Chicago & North Western 83 Children's Group 100 Chrysler 54 Clarion Performance Properties 96 Coca-Cola 46 Columbia Healthcare 30 Combustion Engineering 72 Comcast 42 Compaq Computer 88 Conde Nast 6 Context 52 Continental Bank 30 C.P. Baker 33 Crate & Barrel 74 CS First Boston 33, 38, 40	G Gap 74 Geffen Records 42 Genentech 76 GE 30, 54, 72 General Magic 88 General Mills 46, 74 General Signal 30 Gillette 96 GM 30, 96 Goldman Sachs 52, 70 Graff Pay-Per-View 52 GTech Holdings 86 Gucci 74	N National Football League Properties 96 National Pools 8 NEC 88 New Hampton 74 New York Life Insurance 60 News 86 Nextel Communications 34 Nordion International 76 Northrop-Grumman 32	T Tandy/Casio 20 Tele-Communications 42 Texas Instruments 46 Textron 32 Time Warner 40, 74, 86 Toshiba 88 Tridex 86
D	Dain Bosworth 74 D'Arcy, Masius, Benton & Bowles 96 Dart Group 46 DataTech Software 102 Davis 70 Delco Electronics 96 Delta Air Lines 6 DePuy 76 Deutsche Telekom 52 Diversified Pharmaceutical Services 35 Donaldson, Lufkin & Jenrette 83	H Hamilton Advisors 83 Hasbro 12 Hearst 6 Hellman & Friedman 84 Heritage Partners 84 Hewlett-Packard 20 Home Shopping Network 74 Hughes 32	O Occidental Petroleum 70 Olivetti 88 O'Mara Plumbing 34 Osiris Therapeutics 76 Otto-Versand 74	U United Airlines 46 United International Holdings 52 United Technologies 32 USAir 30 U.S. Biomaterials 76 U.S. Playing Card 83
		I IBM 54, 70, 86, 88 IDB Communications 90 Integrated Orbital Implants 76 Intel 88 International Management Group 96 Interpore International 76 Intuit 20 Invesco Funds Group 98 ISL Marketing 96 IVAX 46	P Paramount 40, 42 PCS Health Systems 30 Pennzoil 96 Philip Morris 46 Philips Electronics 40, 52 Piper Jaffray 98 Pitney Bowes 70 Pizza Hut 8 Portable Software 20 Printon 80 Procter & Gamble 70, 96 Prudential Securities 26	V Valvoline 96 Vox Music Group 100
		J J.C. Penney 74 Jersey Central Power & Light 72 Johnson & Johnson 35	Q Q2 74 QVC 42, 74	W Wal-Mart 60 Walt Disney 40, 42, 52, 70 Westinghouse 54, 70, 77 Williams 90 Williams Sonoma 74 WiTel Network Services
		K K-III Communications 83 Knopf 100 Koch International 100 Kohlberg Kravis Roberts 83 KSL Recreation 83 Kyocera 76		X Xerox 70
				Z Zenith 88 Zenith Laboratories 46

Investment Figures of the Week

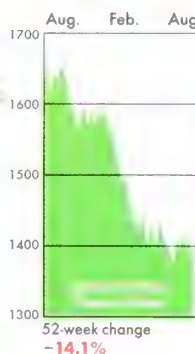
MENTARY

Stock market rallied in the dog of summer, taking investors wild ride. After huge short pos sparked a 70.90-point gain g. 24, the Dow closed at on Aug. 31, its highest level Feb. 22. Signs of slowing ecic growth helped, as inflation abated. The high-octane A proposed \$10 billion mer between Lockheed Corp. and Marietta Corp. That ad a rise in defense stocks reled speculation of more r and acquisition activity.

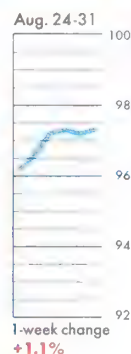
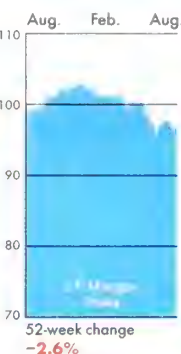
STOCKS



BONDS



THE DOLLAR



MARKET ANALYSIS

STOCKS	Latest	% change Week	% change 52-week
DOW JONES INDUSTRIALS	3913.4	1.7	7.4
DOW JONES COMPANIES (S&P MidCap Index)	178.4	1.5	2.4
DOW JONES COMPANIES (Russell 2000)	257.3	1.8	4.1
DOW JONES COMPANIES (Russell 3000)	273.3	1.4	2.1

INTERNATIONAL STOCKS	Latest	% change (local currency) Week	% change 52-week
DOW JONES FINANCIAL TIMES 100	3251.3	1.4	5.4
DOW JONES NIKKEI INDEX	20,628.5	0.6	-1.5
DOW JONES TOYO TSE COMPOSITE	4349.5	2.0	5.0

FUNDAMENTALS	Latest	Week ago	Year ago
90-DAY TREASURY BILL YIELD	4.66%	4.63%	3.08%
30-YEAR TREASURY BOND YIELD	7.45%	7.46%	6.09%
S&P 500 DIVIDEND YIELD	2.67%	2.71%	2.70%
S&P 500 PRICE/EARNINGS RATIO	18.9	18.7	24.0

TECHNICAL INDICATORS	Latest	Week ago	Reading
S&P 500 200-day moving average	460.6	460.3	Positive
Stocks above 200-day moving average	44.0%	40.0%	Neutral
Speculative sentiment: Put/call ratio	0.32	0.36	Neutral
Insider sentiment: Vickers sell/buy ratio	0.98	0.91	Positive

INDUSTRY GROUPS

MONTH LEADERS	% change 1-month	% change 12-month
TELECOMMUNICATIONS EQUIPMENT	17.5	9.5
INSTRUMENTATION	15.9	21.9
COMPUTER SYSTEMS	14.6	42.2
UTILITIES	13.4	12.0
PERSONAL LOANS	11.9	5.7

MONTH LAGGARDS	% change 1-month	% change 12-month
OIL AND GAS DRILLING	-6.9	-25.0
WELL EQUIPMENT AND SERVICES	-5.7	-17.0
EXPLORATION AND PRODUCTION	-3.4	-28.9
PROPERTY-CASUALTY INSURERS	-1.9	-17.1
INSURE TIME	-1.3	29.1

Strongest stock in group	% change 1-month	% change 12-month	Price
SCIENTIFIC-ATLANTA	27.6	20.3	44 1/2
HEWLETT-PACKARD	16.8	24.1	90 3/8
DIGITAL EQUIPMENT	30.3	-38.6	25 1/4
UPJOHN	23.3	34.6	37
HOUSEHOLD INTERNATIONAL	15.1	2.3	39 1/8

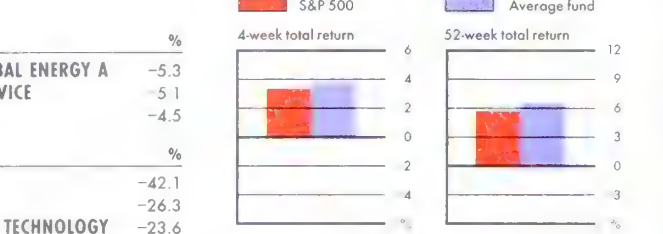
Weakest stock in group	% change 1-month	% change 12-month	Price
ROWAN	-10.6	-25.3	7 3/8
BAKER HUGHES	-11.2	-32.1	18 3/4
ORYX ENERGY	-7.3	-39.7	14 1/4
GENERAL RE	-3.0	-14.2	112 1/8
BRUNSWICK	-5.2	50.8	22 3/8

MUTUAL FUNDS

LEADERS	Week total return	%
AMERICAN LATIN AMERICA GROWTH A	16.9	
AMERICAN LATIN AMERICAN VALUE	15.4	
AMERICAN LATIN AMERICAN	15.3	

LAGGARDS	Four-week total return	%
STATE STREET RESEARCH GLOBAL ENERGY A	-5.3	
FIDELITY SELECT ENERGY SERVICE	-5.1	
MONITREND GOLD	-4.5	

	52-week total return	%
MONITREND GOLD	-42.1	
AMERICAN HERITAGE	-26.3	
STEADMAN OCEANOGRAPHIC TECHNOLOGY	-23.6	



RELATIVE PORTFOLIOS

Amounts sent the present of \$10,000 one year ago	Foreign stocks	U.S. stocks	Gold	Money market fund	Treasury bonds
Changes indicate year total returns	\$11,756 -0.61%	\$10,561 +2.49%	\$10,470 +1.38%	\$10,203 +0.05%	\$9,273 +0.99%

on this page are as of market close Wednesday, Aug. 31, 1994, unless otherwise indicated. groups include S&P 500 companies only; performance and share prices are as of market close

Aug. 30. Mutual fund returns are as of Aug. 26. Relative portfolios are valued as of Aug. 30. A more detailed explanation of this page is available on request. r = revised

CUBA ISN'T READY FOR A CHINA-STYLE OPENING

Cuba is not China. Despite the parallels being drawn by advocates of lifting the U.S. trade embargo on Cuba, the comparison doesn't work. Capitalism may indeed be destroying communism in China, but it is a strong domestic market economy, not trade per se, that is subverting the state-owned sector. Lifting the Cuban embargo before Fidel Castro opens the country to free-market forces can only reinforce his dictatorship, not destroy it from within.

The differences between China and Cuba are striking. The human-rights landscape is ugly in both countries. But China has a vibrant market economy dominated by millions of small entrepreneurs that is swiftly swallowing the state-controlled economy. China's military is shrinking, and generals are becoming tycoons. In this context, trade promotes market activity and expands the personal freedom of millions of Chinese.

Cuba remains a top-down economy run by the Communist Party. A few European-financed hotels for Canadian, French, and Italian tourists don't change the spots of a command economy. Neither does "dollarization," with separate shops selling foreign goods (and Cuban cigars) for U.S. dollars. Profits are used to pay for a large government bureaucracy and a big standing army.

There are clear differences between the Chinese and Cuban expatriate classes as well. Chinese exiles in Taiwan, Hong Kong, and Southeast Asia drive China's new market economy. They provide much of the capital, entrepreneurial skill, and international trade connections. With Beijing willing to create a market economy, overseas Chinese are willing to build businesses and create a new middle class.

Not so the wealthy Cuban exiles in Miami. They want the Castro regime out—or dramatically changed—before investing in Cuba. They believe that until Cuba's command economy is dismantled, no amount of trade or investment will generate the kind of growth that produces a middle-class way of life.

Until Havana shifts to a market economy, lifting the embargo is a fruitless gesture on Washington's part. Individual freedoms can only be expanded through trade if a genuine market economy is permitted to operate. Conservatives and liberals pushing the Clinton Administration to drop America's long-standing trade ban with Cuba are being economically and politically naive.

LET THE BOOMERS BUILD THEIR NEST EGGS

Much blather is being written about the "generational" wars and how the twentysomething set will be taxed to the sky to pay for the retirement of free-spending boomers who refuse to save. The conventional wisdom is that the nation faces a crisis as private pensions prove inadequate and Social Security goes bankrupt.

Don't bet on it. The hand-wringing is based on two economic assumptions: that America's low productivity rate will continue and that the country's anemic savings rate will stay the same. But what if these assumptions are wrong?

Take productivity. It is up and by a lot. Technology is providing the tools, and global trade is applying the whip of competition. While productivity rose at less than a 1% rate for much of the '70s and '80s, it is now expanding by 1.5% a year. That extra productivity could generate enough growth and wealth to support plenty of boomer geezers.

O.K., but what about the boomer's miserable record on savings? The personal savings rate has plummeted from about 7% in the 1960s through the 1980s to 4.5% in the 1990s. However, aging boomers are quickly moving into their 40s and 50s, years when people tend to save more. Boomers are already pouring tens of billions into mutual funds and their 401(k) defined-contribution pension plans.

They would put more away if Washington would stop being so schizophrenic about savings. The government can make up its mind whether it wants to encourage retirement savings or generate more revenue. First, it encouraged individual retirement accounts, then it killed them for most people. It promoted 401(k)s, but recently it tightened the rules.

Expanding IRAs and the amount of pretax income people can stuff into 401(k)s would be a real boost for boomers building nest eggs. But that, of course, means Washington would have to cut spending to make up for lost revenue.

It should do just that. With productivity apparently rising for the long haul and the boomers entering their saving years, a cut in spending by Washington could lock in prosperity and security for all generations in the decades ahead.

THIS CONSOLIDATION WAVE COULD GET OUT OF HAND

After the wild excesses of the 1980s, the current wave of mergers and acquisitions naturally invites concern. Name an industry, be it defense, drugs, health care, telecommunications, banking, or retailing, and there's consolidation.

Should we worry? The barbarians are not again at the gates, at least not yet. These deals are not being driven solely by financial gimmickry. Constructive forces are at work, from global competition to the end of the cold war to health-care cost-cutting.

Yet vertical integration and oligopoly pricing power are fearsome economic forces. The histories of both the defense and health-care industries are replete with examples of overcharging. Cable, cellular, and phone companies all have monopoly backgrounds. Consolidation may prove so tempting that some companies might take unfair advantage of their market power.

Assistant Attorney General for Antitrust Anne K. Binns has been more activist than her predecessors. Now's the time for her to decide whether the recent trend toward megadeals and industrial concentration is getting out of hand.

It used to take 14 hours for Landis & Gyr engineers in Chicago to meet with colleagues in Zug, Switzerland.

Today, thanks to a real solution from Sprint Business, they spend those hours working together. Meeting face-to-face

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THE GLOBAL INVESTOR

PAGE 96

The world's best stocks come to the U.S. market



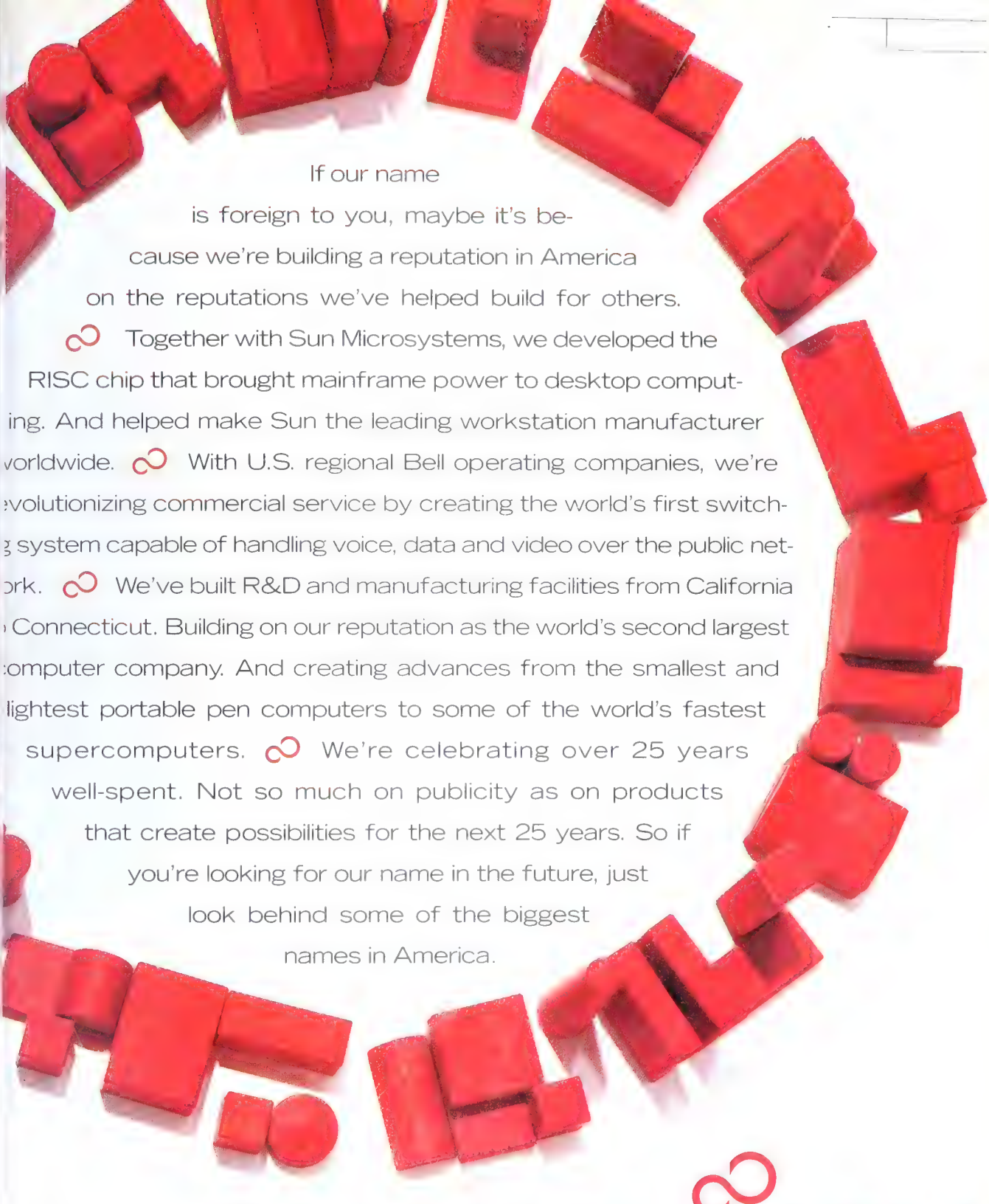
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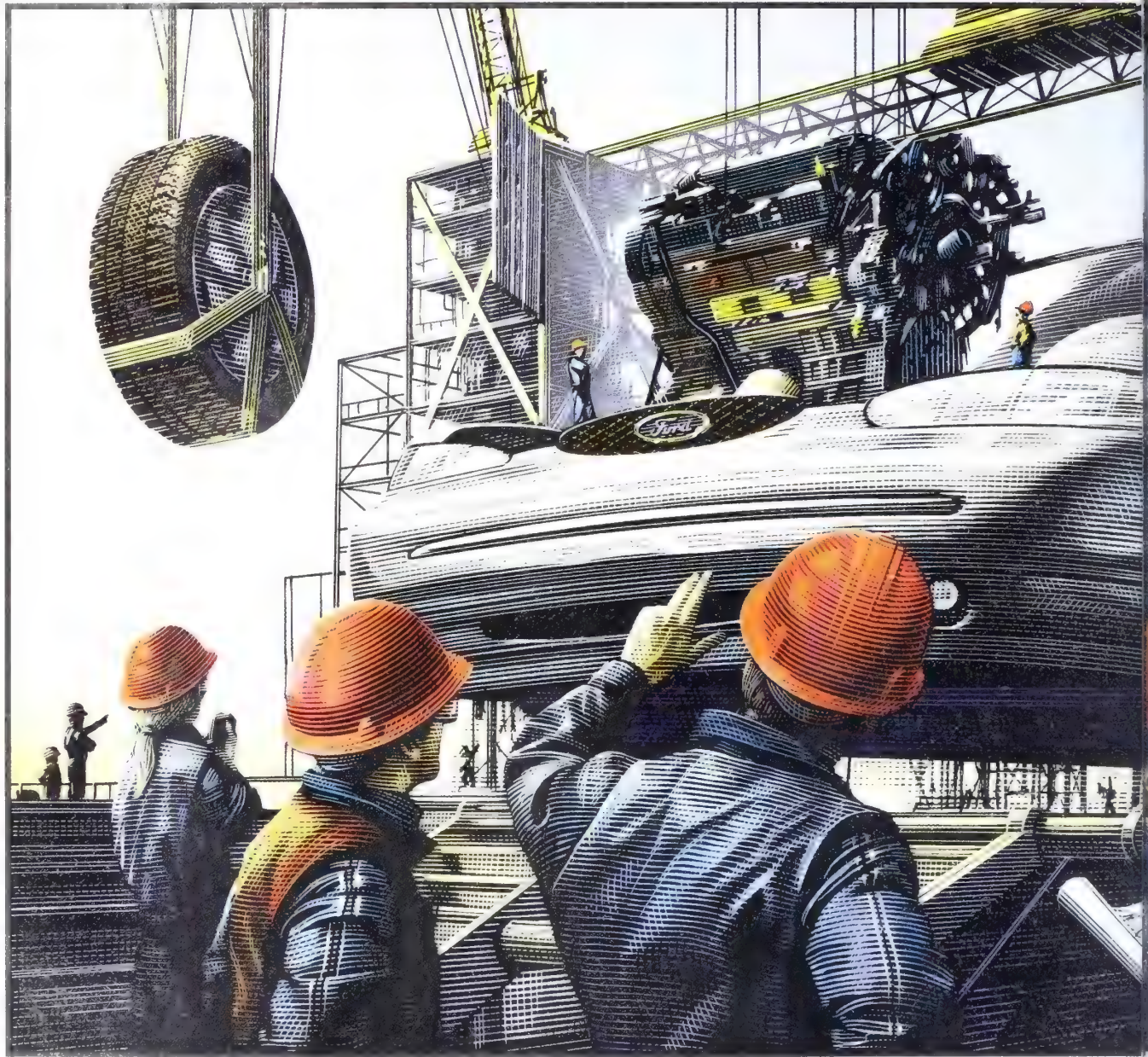
look behind some of the biggest

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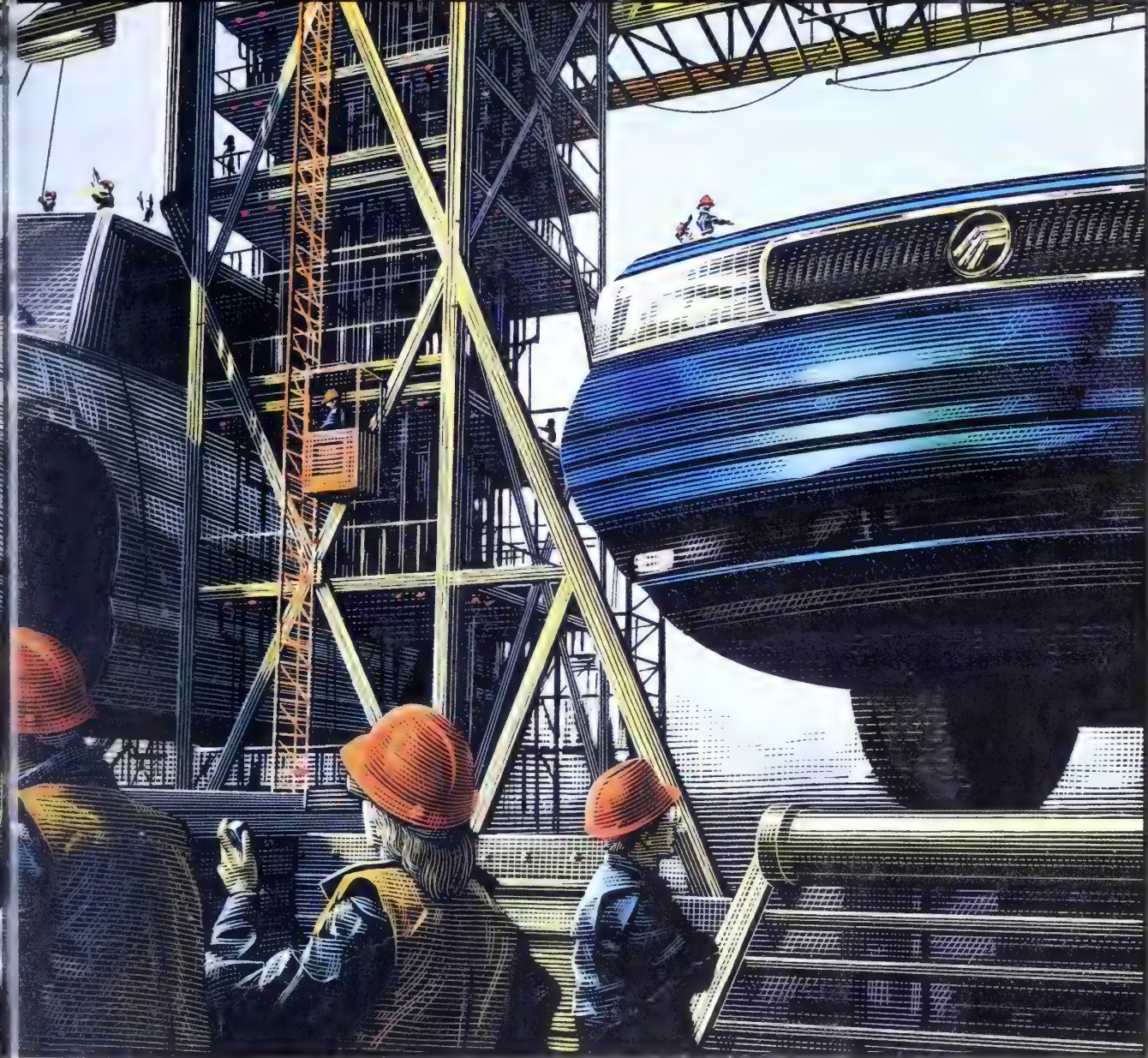


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POWER TOOLS: WHEN BRITAIN'S ENTERPRISE OIL TRIED TO TAKE OVER ANOTHER PRODUCER, LASMO, IT OFFERED BLOCKS OF ADRs TO AMERICANS

Special Report

96 THE GLOBAL INVESTOR

With a world economic recovery gathering speed, American investors are falling in love with overseas stocks. And thanks to the sudden blossoming of the American Depositary Receipt—a long-ignored instrument that makes trading in foreign equities quick and easy—they're snapping up the issues of scores of small and large companies from Australia to Zimbabwe

102 MEXICO'S NEWEST CALLING CARD

A telecom giant is luring investors

104 THE GLOBAL INFOPIKE

Getting the on-line scoop on ADRs

Top of the News

30 DETROIT IS BURNING RUBBER

A strong yen means the Big Three could carve out more market share

32 CORPORATE AMERICA AND CUBA

Companies are itching to trade there

33 COMMENTARY

The GOP should get behind GATT

34 GRASSROOTS GRUMBLING

In Pennsylvania, support for health reform has turned to skepticism

35 COMMENTARY

The death throes of health reform

36 LOCK THE DOORS, IT'S EDS

Rival consultants are mad over raids

37 AND A PC UNDER EVERY TREE

Christmas could be computer season

38 ZIGZAGS AT TIME WARNER

Chairman Levin's overtures to NBC

40 A GHOULISH DEBATE

Should buying life-insurance policies of AIDS patients be better regulated?

42 THE CAMPUS COLA WARS

Colleges play off Coke against Pepsi

42 UNITED PICKS A DOGFIGHT

A new shuttle takes on Southwest

43 THE SLAM-BAM GOLF TOURNEY

The PGA Tour edges out IMG

43 P&G: SKINNING COPYCATS

It's suing over brand mimicry

44 IN BUSINESS THIS WEEK

International Business

48 TRADE

The U.S. export boom appears to be gaining new momentum...

49 TRADE

...But rising imports are making the U.S. trade gap wider

50 CANADA

The Liberals face an uphill fight in Quebec

54 INTERNATIONAL OUTLOOK

Europe now tries unification for the favored few

Economic Analysis

22 ECONOMIC VIEWPOINT

Dornbusch: How not to safeguard South Africa's democracy

24 ECONOMIC TRENDS

Slow job growth, NAFTA's mixed message, college degrees and wages, long-term worries

27 BUSINESS OUTLOOK

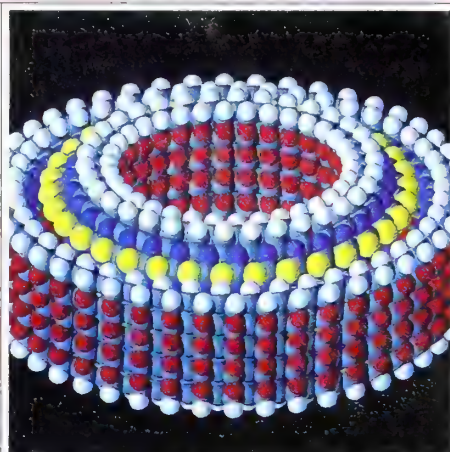
The chill is finally creeping into the labor markets



30 IN THE PASSING LANE:
THANKS PARTLY TO NEW MODELS LIKE THE CHRYSLER CIRRUS, DETROIT HAS ITS BEST CHANCE IN YEARS TO NAB SHARE AWAY FROM THE JAPANESE



59 A SMOKIN' MARLBORO MAN:
THE COMBATIVE GEOFF BIBLE, PHILIP MORRIS' NEW CEO, IS ALREADY RUSHING TO DEFEND HIS TOBACCO BUSINESS ON ALL FRONTS



76 CALL IT DIGITAL SCIENCE:
EVER-CHEAPER COMPUTING POWER IS TRANSFORMING RESEARCH, EVEN ALLOWING SCIENTISTS TO BUILD NANO-MACHINES ATOM BY ATOM

Government

- 47 WASHINGTON OUTLOOK**
Why voters may not care if Clinton streamlines government
- 91 HARSH RX FOR PENSION PLANS**
Castor now, say the Clintonites, could prevent a bailout later
- 92 MORE NEST EGGS**
401(k) plans have workers saving

The Corporation

- 56 COLGATE'S CAVITY**
Its household products have taken a drubbing in the U.S.
- 58 NOW, DESIGNER MOTOR OILS?**
Quaker State's new marketing plan

People

- 59 PHILIP MORRIS' SCRAPPY BOSS**
New CEO Geoff Bible is a smoker and a drinker who's fighting for his embattled company

Information Processing

- 19 TECHNOLOGY AND YOU**
Legal Aid on a disk
- 56 PHONE DISCOUNTS? SURE, BUT...**
Rate deals offered by AT&T, MCI, and Sprint are offset by rate hikes
- 58 BE CAREFUL WHAT YOU BID FOR**
James Hartley thought he wanted a license for interactive TV
- 72 IBM'S TECHNOLOGY BOUTIQUE**
It's hawking its knowhow

Science & Technology

- 76 INTO THE VIRTUAL LAB**
The computer is taking scientists on fantastic journeys
- 84 MIRACLE IN MAUI**
Supercomputing for the masses
- 90 DEVELOPMENTS TO WATCH**
Heat and circuits, trucker-watching, shellfish, hearts, metal fractures

Finance

- 109 AN IMPROVED RETIREMENT PLAY?**
Hundreds of companies bet on a supposedly safer version of GICs



- 128 HOW ABOUT A BALI HIGH?**
BUSINESS WEEK CHECKS OUT SOME TOP-OF-THE-LINE TOURING SPOTS AND ACCOMMODATIONS FOR THE SYBARIOTIC AT HEART

- 112 THE PUSH TO BUY DOCTORS**
As insurance companies quietly acquire medical practices, critics worry that care will suffer
- 114 A BANK BOSS AT THE BRINK**
Michigan National's chief executive is under fire
- 118 T-BILL MANIA--IN RUSSIA**
A hot market in government debt is helping to tame inflation
- 122 INSIDE WALL STREET**
A red-tag special at Mercantile? Really getting the lead out Out in front at the trailer park
- 137 INVESTMENT FIGURES OF THE WEEK**

Personal Business

- 128 GOING FIRST CLASS**
BALI: Close to heaven
BIMINI, BAHAMAS: Superscuba
SARANAC LAKE, N.Y.: Luxury lodge

Features

- 6 UP FRONT**
- 12 READERS REPORT**
- 16 CORRECTIONS & CLARIFICATIONS**
- 18 BOOKS**
Hamel and Prahalad: *Competing for the Future*
- 135 BUSINESS WEEK INDEX**
- 136 INDEX TO COMPANIES**
- 138 EDITORIALS**
A capital shortage? No way
Try for a little health reform

Up Front

EDITED BY LARRY LIGHT AND JULIE TILSNER



HOT SEAT: Gonzalez is drawing grumbles

SLUGFESTS

GUNNING FOR GONZO

House Banking Chairman Henry Gonzalez (D-Tex.), one of the most irascible and quixotic leaders in Congress, may be facing another fight to retain his gavel. With long-standing grumbling among committee members resurfacing about the outspoken populist, there is new talk about a challenge to his chairmanship after the midterm elections. Eyes are on Representative Bruce Vento (D-Minn.), who made an unsuccessful run at "Gonzo" four years ago.

Ongoing complaints include Gonzalez' abrasive style and refusal to coordinate with fellow members. His assaults on the Federal Reserve have made him powerful enemies

within the central bank. And his heavy-handed partisanship in running the House Whitewater hearings—with tight limits on GOP questioning—helped embarrass the Democrats by making them look eager to cover up for the Clinton Administration.

Removing a sitting chairman is never easy. And Capitol Hill observers bet the committee's recent successes—including expected passage of interstate banking reform—would help Gonzalez win. A spokesman for Vento says the Congressman has no plans for a coup. A Gonzalez spokeswoman says she has "heard nothing" about a potential challenge. *Amy Barrett*

AFTERLIVES

A ZOMBIE WITH ZIP

Return of the dead? N.J. Nicholas, former co-CEO of Time Warner, is devoting his time and money to a company called Zombie. Nicholas, who recently became the majority investor in this Seattle-based virtual-reality startup, also is a Zombie adviser and

TALK SHOW

It's not unlike insisting on settling the fate of Jerusalem between Arabs and Israelis.

—Federal mediators' memo on the baseball salary cap issue. The White House declined on Sept. 7 to intervene in the strike

SICKNESS AND HEALTH

BUT WHERE ARE THE PATIENTS?

A gleaming temple to high-tech medicine on the outskirts of Glasgow, opened last spring by two former Harvard Medical School profs, is virtually empty. The Health Care International hospital admits it needs 50% occupancy to break even. It has 10%.

The \$279 million medical complex is aimed at a wealthy global clientele. The hospital boasts state-of-the-art equipment and even a four-star hotel with a swanky bar. Thanks to lower

Scottish labor costs and government subsidies, it charges one-third less than comparable U.S. hospitals for intricate procedures.

Critics say the problem is marketing—which HCI is working on by trying to get such groups as the Saudi royal family to sign up for a medical plan. Insisting it will be profitable by 1995, HCI plans to raise \$25 million in fresh capital this fall. *Julia Flynn*



AN OLD REMEDY at Glasgow's high-tech hospital

director. He won't say how much he has put in, but there's a lot available. His severance package from Time Warner, where he was ousted in 1992: \$18.7 million.

Zombie is developing virtual-reality technology for home computer and video games. The name is an in-your-face to critics who say video games turn kids into the living dead. Co-

founders Joanna Alexander and Mark Long, who hooked up at the David Sarnoff Research Center, found it easy to get Nicholas to invest

Nicholas, 55, helped launch HBO for Time and has a big interest in new media ventures. "After 30 years of doing the huge corporate thing, this is the flip side, and it's lots of fun."



NICHOLAS: "Fun"

PICKING THE PREZ

NOW THIS IS AN 'A' LIST

Why not pick a President the way companies find CEOs—with headhunters? That's the notion in a new book that disdains the Presidents the current system often produces. For *The Second American Revolution*, ad honchos James Patterson, chairman of J. Walter Thompson, North America, and Peter Kim, v'ce-chairman of McCann-Erickson Worldwide, had executive searchers Gilbert Tweed Associates of New York assemble a seven-name short list of those

with the right leadership, integrity, and vision.

Making the roster are two prominent corporate leaders: Sara Lee CEO John Bryan and Merck

Chairman Roy Vagelos. The authors laud them for business acumen and social conscience. The others on the list have served as public officials (table). Only one has run for President (in 1988),

Jack Kemp, but he may not attempt an-

other race in 1996 (page 47)

The authors' system isn't exactly democratic. While focus groups of regular folks specified the desirable Oval Office qualities, the headhunters compiled the list, which is diverse in ideology, gender and race. Another poll of 1,067 people ranked the seven. Kemp was No. 1 with 27%; Bryan No. 2 at 16%. Will the two corporate chiefs consider politics? "Oh, my goodness, no," says Bryan spokeswoman. Laaments Kim: "Not enough candidates with these people's character are willing to enter public life." *Richard S. Dunham*

HEADHUNTERS' PRESIDENTIAL PICKS

1. JACK KEMP EX-HUD SECRETARY
2. JOHN BRYAN SARA LEE CEO
3. ANN RICHARDS TEXAS GOVERNOR
4. WARREN RUDMAN EX-SENATOR
5. DONNA SHALALA HHS SECRETARY
6. ROY VAGELOS MERCK CHAIRMAN
7. BARBARA JORDAN EX-REPRESENTATIVE

DATA: *THE SECOND AMERICAN REVOLUTION* BY JAMES PATTERSON AND PETER KIM



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THE KOREAS: WILL THE WALLS FALL?

The pressure is on Seoul to let South Korean business break down the walls separating the two Koreas. If the U.S. and North Korea maintain momentum at upcoming talks over nuclear arms and diplomatic ties, South Korean



DEALS? The South wants Kim's cheap labor

executives expect their government to permit a burst of deals with the regime of Kim Jong Il.

The *chaebol*, South Korea's huge conglomerates, are eager to win access to the cheap, disciplined labor of the North to offset soaring labor

costs in the South. South Korean makers of textiles, footwear, and other low-end products have lost out to cheaper competition from China.

South Korean companies have been painstakingly building connections in the North, often through third parties. Daewoo has agreements with Pyongyang to set up eight industrial facilities once it gets Seoul's O.K. Hyundai is studying tourism and a ship-repair project. And there's a plan for a natural-gas pipeline from Russia to Japan via the Korean peninsula.

But Japan could complicate this surge in intra-Korean business. The South fears that Japan might start competing with them in manufacturing low-cost components in the North's industrial parks or trade zones. Japanese officials say that Tokyo would even look kindly on paying war reparations to the North. In the 1960s, Seoul received \$500 million from Tokyo for Japan's military occupation. *Laxmi Nakarmi*

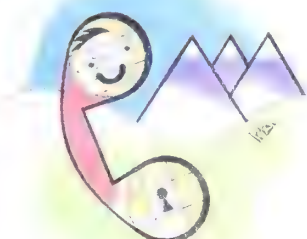
TIMESERVERS

AND THE LANDSCAPE IS A KILLER

Want to know about visiting Iowa? Ask a convict. Prisoners in other states may be stamping out license plates, but in Iowa they field calls for tourism information.

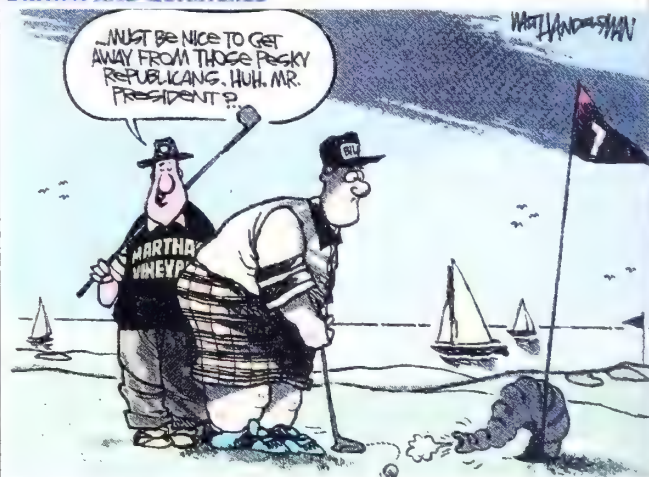
official Nancy Landess. Although a few other states have employed minimum-security prisoners to answer tourism calls, Iowa is the first to use murderers and armed robbers, says Ken Wittry, an official at the state's Fort Madison penitentiary.

So far there have been no complaints from callers, who have no way of knowing they are talking with convicts. Inmates are screened for phone aptitude before they join the program, then undergo training on telephone etiquette, the computer and phone systems, and Iowa facts. The hardest thing for the inmates to cope with has been the tourists' upbeat attitude. Says Landess: "They aren't used to people telling them to have a good day." *Susan Chandler*



Working for 40¢ to 70¢ an hour, the inmates have helped the state's tourism division cut costs by 25% since the program got under way in January, says Iowa tourism

DRAWN AND QUARTERED



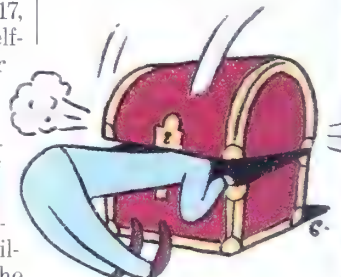
BURIED TREASURE

SCRUTINY ON THE BOUNTY

Ten years ago, the discovery of the treasure-laden pirate ship *Whydah*, which sank off Cape Cod in 1717, sparked a media frenzy. Self-described treasure hunter Barry Clifford raised \$6 million from investors to reclaim the buccaneers' booty. Based on a number of gold and silver coins found at the site, Clifford estimated it to be worth \$400 million. Since then, none of the investors in Clifford's *Whydah* Partners has seen one doubloon of return.

What happened? Well, they finished excavating the ship's goods in 1988. There wasn't

as much as Clifford had thought—even his experts estimate the swag to be worth at most \$4 million, likely less. Clifford didn't return calls but now seems to want to put what treasure there is on display. Now, it's in a Pr



vincetown (Mass.) museum. The investors are peeved but paralyzed. Their lawyers told them the expense of suing *Whydah* Partners wouldn't be worth the measly return.

THE BIG PICTURE

THE MONEY GAME

How well do you handle your personal finances? A survey shows that most Americans think they do an excellent job of paying bills, but few think they do a good job getting the best return on savings.

FINANCIAL TASKS HANDLED WELL MOST OFTEN

Paying bills on time

51%

Staying out of debt

35%

Balancing checkbook

35%

FINANCIAL TASKS HANDLED WELL LEAST OFTEN

Saving money

18%

Planning for retirement

17%

Best return on savings

13%

DATA: DAVID MICHAELSON & ASSOC. FOR MASTERCARD INTERNATIONAL, INC.

FOOTNOTES

Personal-computer unit shipments for home use, 1993: **5.3 million**; 1996 (est.): **9.8 million**; 1998 (est.): **13.9 million**

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GLOBAL EXCELLENCE

"I hate calculating tips
and overtime"

Joe Dazey, Owner
Timely Truck Stop

"I hate time expenses
I need better control
of my time"

James Martin, CMO
Charm Life Insurance Co.

"I hate the time it takes
to track benefits eligibility"

Susan Hoffman, Benefits Administrator
East Coast Maintenance Corp.

"I hate the year-end crunch"

Libby Fiksel, Office Manager
Homer's Markets

"I hate not having easy
access to my data"

Warren Godfrey, Finance Manager
Bon Design

"I hate to think
of overpaying taxes"

Debra Evans, Partner
Wain & Rankin Consulting

"I hate worrying about changes
in government regulations"

Andy Kubic, Controller
Daly's Fashion Emporium

"I hate wasting time maintaining
separate Payroll and HR Systems"

Kevin Foley, V.P. Human Resources
American Bedding & Furniture Co.

"I hate dealing with State
Unemployment Agencies"

Tracy Hirth, Human Resources Director
Dan Adams Steel Service Inc.

"I hate backed up jobs"

Jerry Brady, Custodial Engineer
State County Bus Co.

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**JOB KILLERS:
WHAT KUTTNER MISSED**

Robert Kuttner's commentary "Where have all the good jobs gone?" (Economic Viewpoint, Aug. 29) misses one of the most important reasons that the U.S. generates more new service jobs than new manufacturing jobs: American taxes. Manufacturing jobs require capital investments that can reach several hundred thousand dollars per worker. Yet the U.S. taxes capital much more heavily than income.

Capital-gains taxes, just by treating inflationary gains like real gains, takes 1% to 2% per year of capital, amounting over the last 25 years to a quarter of existing American capital. While capital-gains taxes can be deferred by not selling assets, that has the perverse consequence of immobilizing capital and preventing its efficient investment. Income taxes on businesses, by focusing on profits rather than revenues, reward poorly run companies and penalize well-run companies, again distorting the efficient use of capital.

A flat-rate consumption tax on individuals would allow the retention and growth of capital that is needed to create good manufacturing jobs for American workers.

Daniel E. Cullen
Princeton, N.J.

Kuttner must have missed the most serious job-killer of all: increased government regulations and mandates that raise the cost of hiring.

Michael J. Gallagher
Spring Grove, Ill.

**ROCHESTER'S RALLY AROUND
'PURE COMMUNITY RATING'**

The commentary "Keeping the health plan from kicking the bucket" by Mike McNamee (Top of the News, Aug. 29) asserts that "pure community rating," where all insured pay the same premium for the same coverage, is unfair to younger workers and drives them out of the market. In fact, we know from experience in greater Rochester

that this is not the case. Pure community rating has kept everyone's eye on the real issues of community capacity and community need rather than encouraging everyone to try to maximize their benefit at the expense of others. Not only are our premiums two-thirds of the national average, but our rate of uninsured is half or less than half the national average. Other communities around the nation would do well to emulate this model.

Rene H. Reixach
Executive Director
Finger Lakes Health Systems Agency
Rochester, N.Y.

**SIX BILLION PEOPLE
ON THE PLANET? NAH**

Why does nobody question the premise behind "Too many people?" (Social Issues, Aug. 8)? World population figures are a compilation of data supplied by member nations, many of which have had no census for decades. Others have built-in political biases while some have never had a census at all. We are left with estimates by governments, all of which have a motive for exaggeration—more aid, more investment, more importance.

There are a great many proxies which indicate population densities—food, energy, money in circulation. These suggest that there were really the 6 billion alleged, famine and hardship would be far greater than it manifestly is. Populations simply do not exceed levels warranted by the available resources. Postulating a world crisis gives wonderful excuses for expensive conferences instead of tackling chronic local problems among the probable 4 billion.

J. Richard Graham
London

**DISCOUNT STOCKS: A NOTE
ON THIRD-MARKET COSTS**

Suzanne Woolley's article "Are super-deep discounters as cheap as they seem?" (Finance, Aug. 29) was (unintentionally, I am sure) misleading. She quoted a broker at a "traditional" discount who said that the third-market-execu-

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*John A. Jamison
Executive Vice President
TRW Occupant Restraint
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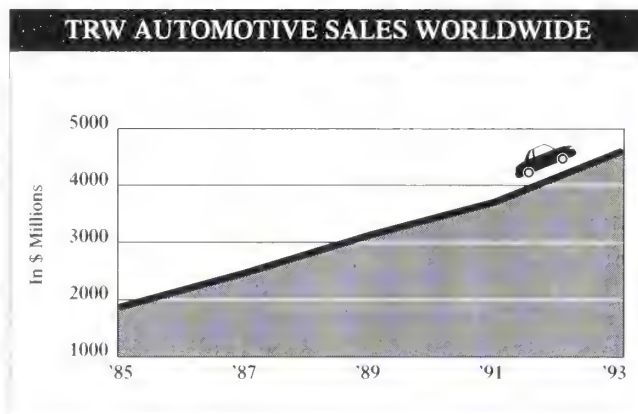
system

TRW's automotive sales have more than doubled over the past nine years. I believe a key to that growth is our ability to develop, design, test, and manufacture systems. Having whole-system capability means we bring an unmatched breadth of knowledge, experience, and skill to our customer's team.

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To be the strongest possible partner for automobile manufacturers, a supplier must know how to integrate all related technologies into a total vehicle system. That's TRW's special strength. TRW

pioneered systems integration in the aerospace industry. In our automotive businesses, this core competency has made us a leading supplier of



Steady increase in TRW automotive sales is supported by TRW's systems capabilities.

steering and suspension systems, valve train systems, electronic systems, and occupant restraint systems.

By designing and manufacturing systems, we have more to offer our customers. Our whole-system focus is one of the major reasons for TRW's success.

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Readers Report

tions cost of a 2,000-share order was one-eighth higher on the third market than it would have been if the order had been placed on the New York Stock Exchange.

There is no way that anyone can be certain that the price obtainable on a 2,000 share order on one market would be one-eighth better than that on another market—unless two orders for 2,000 shares were placed at exactly the same time on each market.

Many full-service firms and “traditional” discounters are paid for order flow. It isn't just the deep discounters that receive payment for order flow. It is the deep discounters, however, who pass through the benefits of order flow by reflecting the payments in reduced commissions.

George A. Brown
Chairman & CEO
Brown & Co.
Boston

OVERSNEERING AT 'OVERSTATED' PRODUCTIVITY GAINS

Regarding your article “The ‘revolution’ in U.S. productivity may be overstated” (Economic Trends, Aug. 29),

CORRECTIONS & CLARIFICATIONS

“Investment Info,” the Bulletin Board item with Technology & You (Sep. 5), gave the wrong Internet address for Quote.Com Inc., a provider of financial information. The correct address is info@quote.com.

the economist David A. Wyss chooses to view his personal computer as a replacement for his \$129 typewriter and not as a replacement for the \$3 million IBM 7094 mainframe. If all the 7094 mainframe did was crunch numbers, then couldn't it be viewed as mostly a replacement for a few \$500 adding machines?

If so, wouldn't that then mean that the productivity gains in the 1960s were also overstated?

After all, the adding machine and the typewriter themselves are nothing but replacements for the even cheaper and older pencil and pen. Therefore, does that suggest that all gains in productivity have merely been overstated?

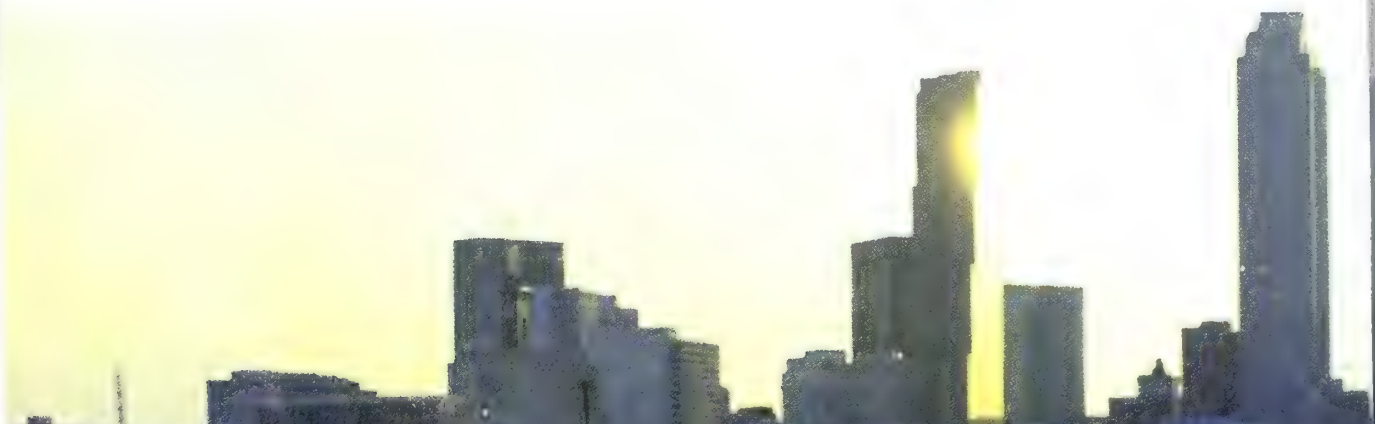
Peter G. Stamoolis
Bethel Park, Pa.

HOW MANY AIRCRAFT CARRIERS DO WE NEED?

Your “Reality Check” is normally an excellent feature because it sticks to ascertainable facts. But the “Reality Check” on why we need fewer aircraft carriers (Up Front, Aug. 29) veers directly into opinions and half-truths. The fact that cruise missiles worked in the gulf war has no more relevance to the need for aircraft carriers than it does to the need for tanks. I also have to wonder what exactly constitutes a “diminished threat”? Twenty years ago, there was only the Soviets and the Chinese. Now there is plutonium being smuggled from Russia, nuclear weapons being made in North Korea, Iranian-sponsored terrorism in the Middle East and elsewhere, civil wars in Africa, drug wars in South America, and instability in the former Soviet bloc. Is the world safer today? My personal reality check says no.

David Hagan
San Diego

You state that Air Force F-111 jets from Britain carried out the 1986 raid on Libya. The majority of the air



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TO BUILD THE COMPANY DOESN'T MEAN YOU
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lift in that strike were from carriers. The Air Force did have planes fly from Britain, but they had to fly down the Atlantic, through the straits of Gibraltar, and on to Libya because our allies didn't want them overflying their countries. By the time the Air Force pilots got to their target, they were exhausted and hardly fit to the task of accurate bombing.

John G. Osborn
Hilton Head Island, S.C.

My Borrus is to be commended for her insightful comments in "Reality Check," and BUSINESS WEEK is to be commended for having the intestinal fortitude to publish her remarks. Recall at the "two major regional wars, near-simultaneous" scenario is a product of the Clinton Administration, designed to hold defense budgets at 90% of cold-war levels. The Navy 12-carrier reaction is in line with that "party line." The no-war scenario has no basis in fact or fiction. Rejection of the scenario and revision of the bottoms-up review might save \$5 billion per year against the carrier program, but applied to all services and strategic enhancement programs could save approximately \$150 billion per year.

Thomas E. Murray Jr.
San Jose, Calif.

CLEARING THE SMOKE OVER SOME CANCERS

Some points need clarification in "The number crunchers drug makers fear and love" (Science & Technology, Aug. 22). We have never attributed to smoking any rises in U.S. cancers of the brain, breast, or testicles; our meta-analysis of drugs are not sponsored by either the Wellcome Foundation or drug makers; and quotations from us, such as "We must be saving a few tens of thousands of lives a year in breast cancer" (or, elsewhere, "millions from death") actually referred to the achievements of the medical profession in general, not just two individuals.

Richard Peto
Rory Collins
University of Oxford
Oxford, England

INCOMNET'S SALES REPS ARE UP, ACTUALLY

Your article ("A phone company with the wrong kind of hum," Finance, Aug. 15) alleges that Incomnet is in trouble because "sales representatives are leaving in droves, some griping the company hasn't paid them."

Incomnet has experienced a substan-

tial net increase in independent sales reps in the first two quarters of 1994 and has continued signing up new reps at a record pace in the first month of the third quarter. While it is true that we lost reps in Northern California, the total damage is about \$500,000—and our company has already recorded earnings of \$1.6 million in the first half of 1994.

To say that reps are leaving in droves when we increase our base of reps almost weekly is a distortion.

Stephen A. Caswell
Vice-President
Incomnet
Woodland Hills, Calif.

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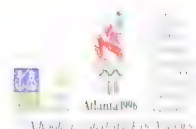
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COMPETING FOR THE FUTURE

By Gary Hamel and C.K. Prahalad

Harvard Business School Press • 327 pp • \$24.95

'CORPORATE ANOREXIA': A LACK-OF-FORESIGHT SAGA

For years now, cost reduction has been a preoccupation of management. So much so that a panoply of buzzwords has emerged to describe it: restructuring and reengineering, downsizing and rightsizing. But there has been surprisingly little focus on future growth.

In *Competing for the Future*, a pair of well-known academics take top executives to task for their eagerness to cut rather than creatively build their businesses for the future. Downsizing, the authors say, is the equivalent of "corporate anorexia." It can make a company thinner, but not necessarily healthier.

That's not an unusual criticism these days. Authors Gary Hamel and C.K. Prahalad, however, make it in the context of a challenge to executives to develop the foresight needed to shape industry evolution. And they offer up a convincing and insightful blueprint to get managers excited about that future.

At a time when many companies continue to lay off thousands in massive reengineering exercises, this is a book that deserves widespread attention. No doubt, it will get it. Both authors are articulate, engaging pros at prominent business schools: Hamel at London Business School, Prahalad at the University of Michigan. Thousands of executives have been exposed to their unconventional thinking in the pair's riveting executive-education courses.

The writers also have been consultants at such corporations as AT&T, Motorola, Ford Motor, and Whirlpool. And they have co-authored seven *Harvard Business Review* articles, including the most reprinted piece in the history of the review, "The Core Competence of the Corporation." All told, it's a recipe for a future best-seller.

This visibility also means, however, that the expectations for this book are

Readers already familiar with such Hamel-Prahalad concepts as "core compe-

tencies" (building up and leveraging the corporation's key skills) will be seeking deeper explanations of these ideas. Yet newcomers must be led carefully into the dense prose endemic in management books written by academics.

By and large, the authors succeed. They're often as entertaining in book form as they are in the classroom. Much to their credit, Hamel and Prahalad are not afraid to offend corporate conventions or laggards. They argue, for example, that the most aggressive downsizers in recent years—such companies as IBM,

existing industry structures. Hamel and Prahalad argue that strategy should be about changing the industry's rules of creating tomorrow's industries.

The authors' premise: A company can control its own destiny only if it understands how to control the destiny of its industry. To do so, it must change in some fundamental way the rules of an industry, much like discount broker Charles Schwab did in the brokerage and mutual-fund businesses. Or it must redraw the boundaries between industries, the way they say Time Warner Inc., Electronic Arts Inc., and other companies are trying to do in the field of "edutainment."

These ideas suggest sometimes bold and courageous moves that few corporate managements can stomach. But the authors maintain that, in their words, "getting to the future first" is preferable to being a prudent follower, waiting for "the other guy to make the mistakes." By entering the laptop-computer business half a decade after Toshiba and Compaq, for example, IBM ceded millions of dollars of profits to its rivals. Similarly, companies such as Samsung and Goldstar have captured much smaller percentages of profits in videocassette recorders than leader Matsushita.

Rethinking existing industries and then implementing strategies to take advantage of change is easier said than done. Yet Hamel and Prahalad lay out questions managers must be asking to gain

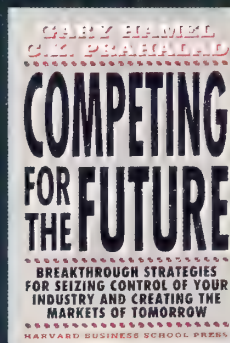
point of view about the future and create a blueprint for getting there. "How do we want this industry to be shaped in five or ten years? What skills and capabilities must we begin to build now if we are to occupy the industry high ground in the future? And how should we organize for opportunities that may not fit neatly within the boundaries of current business units and divisions?"

All in all, the authors want such issues to preoccupy today's managers who sadly seem more interested in laying off workers and controlling costs than putting those same employees to work creating future products and markets. It's a valuable and worthwhile tonic for devotees of today's slash-and-burn school of management.

BY JOHN A. BYRNE

Senior Writer Byrne writes on management topics.

The authors argue
that top executives
have been too eager to
downsize, putting
industry's fate at risk



Eastman Kodak, General Motors, and Westinghouse—are largely a "rogues' gallery of undermanaged or wrongly managed companies." Even some of their own consulting clients, such as AT&T and Kodak, are not spared sometimes harsh criticism. AT&T, they point out, had to bid \$12.6 billion to buy a substantial premium McCaw Cellular Communications Inc. because it missed the opportunity to enter the cellular-telephone business in the early 1980s.

Indeed, the inability of many managers to look ahead for ways to reinvent their industries has led to both costly blunders and monumental catch-up costs. The authors blame executives for being overly insular as well as for adhering to conventions of corporate strategy.

For decades, strategists have spent most of their time figuring out how to position products and businesses within

EDITED BY STEPHEN H. WILDSTROM

LEGAL AID ON A DISK

If legal fees put a dent in your business budget, a talk with your attorney probably conjures up an image of an old-fashioned taximeter ka-chunking as the dollars fly away. Technology won't get lawyers out of your life, but it can make dealing with legal matters easier and less expensive.

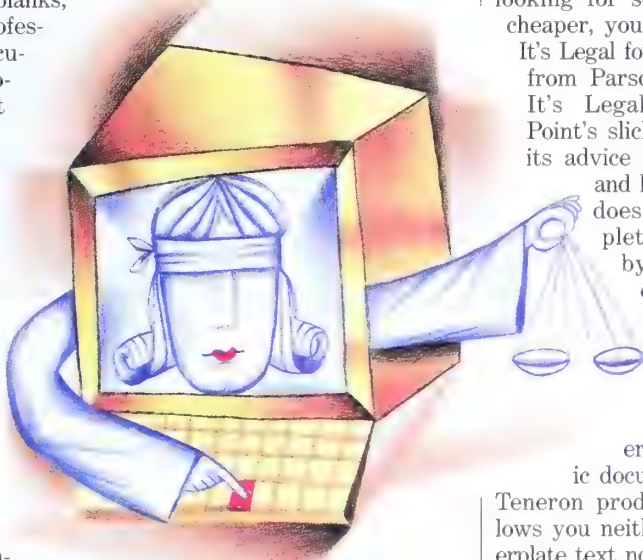
LegalPoint, a new package for Windows from startup Teneration Corp., is based on the principle that most paperwork produced by lawyers is fill-in-the-blanks boilerplate. The \$99 program provides the boilerplate, offers advice on how to fill in the blanks, and turns out professional-looking documents. The program will not eliminate legal issues. As its manual forthrightly declares: "LegalPoint is not a substitute for a good lawyer." Teneration (800 529-5669) wisely recommends that you have your attorney review any legal documents you produce. But it does let you do your own paralegal work and save fees.

Because, as the manual puts it, "the time you normally spend explaining what you want to a lawyer plus the time it takes for a lawyer to draft the document" won't be billed.

The program is easy to start up, handily passing the manual installation test. Indeed, only a quarter of the 10-page manual deals with the program; the rest discusses legal issues, including a guide to choosing a lawyer.

LegalPoint looks like a word processor and can be configured with menus similar to those used by Microsoft Word or Lotus Ami Pro (WordPerfect users are out of luck). You start by selecting the document you want from a menu of 70 mostly business-oriented forms, ranging from a bill of sale to an employment contract to a partnership agreement. On screen, the document is shown in a "what-you-see-is-what-you-get" format, with the blanks to be completed in red.

When you click on a field



to be completed, the program offers you suggestions. In the "employee noncompete" agreement form, for example, the first real decision you must make is the amount of time that a former employee's activities will be restricted. The program offers a choice of 12, 18, or 24 months, along with the advice that courts are likely to reject any restriction that runs for more time than can be justified

as vital to your business.

If you want more extensive advice, a "business law" option provides summaries of legal topics relevant to the task at hand. Topics for an employment agreement include the Fair Labor Standards Act and the Americans with Disabilities Act, while those for an equipment lease cover a summary of types of lease agreements, the Fair Credit Reporting Act, and warranties.

LegalPoint lets you edit any of the text in a document. But you cannot change the document template, and the program does not offer a convenient way to insert your own boilerplate text. You can, however, move a completed form to your word processor to add material, insert a company logo, or polish the formatting.

If your legal needs are more occasional and you're looking for something a bit cheaper, you might consider

It's Legal for Windows (\$49) from Parsons Technology. It's Legal lacks LegalPoint's slick interface, and its advice is more limited and harder to use. It does let you complete many forms by answering questions rather than filling in blanks. But Parsons (800 223-6925) offers far fewer

business-specific documents than the Teneration product. And it allows you neither to edit boilerplate text nor to rework the document in a word processor. Overall, It's Legal seems better suited to home use than to the smaller businesses that are LegalPoint's target market.

For some complicated business needs, even LegalPoint won't help much. For instance, it can't handle an employment agreement that involves compensation in stock. But for most needs of a smaller business, the software can ease both the pain and the cost of legal affairs. S.W.

BULLETIN BOARD

MODEMS

LAPTOP LINK

At first glance, Konexx 204 seems to be a great leap backward. Like the acoustic couplers used on the earliest portable computers, Konexx lets your computer's modem connect to the phone system through the handset rather than a plug in the wall. But unlike its predecessors, the product of San Diego's Unlimited Systems Corp. (619 622-



1400) is an efficient, easy-to-use substitute for a phone jack, which can be hard to find in a hotel or elsewhere on the road. Its design allows it to be used with handsets of a variety of shapes and sizes, a strap holds the unit firmly in place, and it appears to be unaffected by ambient noise at speeds up to 14,400 bits per second. If you're nimble enough to balance a laptop on your arm, it can even be used to connect through a pay phone. The six-ounce, 7½-inch-long Konexx can be a valuable addition to any traveler's bag of tricks.

TRAVEL TIP

THE HOTEL FAX AS PRINTER

Reader Rohn J. Miller of San Francisco offers a tip to travelers who need occasional printouts but don't want to drag a printer around: Use a fax modem to send your document to the hotel's fax. Hotel fax fees can be pricey, but for a few pages, the weight savings may be worth it.

**Of course we're glad 20
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Lufthansa

More than that, you trust

million of you chose
must mean you like us.

us.

June 6, 1994. The sky on board Mr. Lee's plane. 11:00 AM - Hong Kong to Frankfurt.

HOW NOT TO SAFEGUARD SOUTH AFRICA'S DEMOCRACY

BY RUDI DORNBUSCH



Events could tempt Pretoria into adopting economic populism—a shortsighted strategy that can only undermine wage levels further on—and thus democracy itself

When majority rule swept into power in South Africa, the victorious broad coalition hoped that the self-imposed embargo by foreign investors would give way to a return of investment, with beneficial effects for both economic growth and the availability of foreign exchange. Multilateral institutions would do their utmost to help accomplish a soft landing for the critical democratic effort, with billions in International Monetary Fund and World Bank money. The timing was right: World economic growth promised to turn up, and with a troubled dollar, gold prices were doing well.

Unfortunately, things haven't turned out that way. The budget deficit is large—running to at least 6% of gross domestic product. The immediate influx of foreign capital didn't materialize, so foreign-exchange reserves are already depleted. Foreign investors, leery of a situation in which potential profits aren't commensurate with the risks, are standing on the sidelines. Foreign capital infinitely prefers situations where the upside potential is vast if risks must be taken to get in. By that measure, Russia or Brazil, Venezuela, Vietnam, or even China are much more attractive prospects than South Africa.

Whenever a young democracy encounters the challenge of hard economic problems, populism pops out of the wings. And sooner or later, without fail, economic populism translates into economic crisis and ultimately into a drop in real wages. That risk is increasingly apparent in South Africa. If it materializes, the prospects for economic emancipation of the poor black population become slim. Unfortunately, the issue is not narrowly economic. Democracy is called on to come up with results that the economy cannot create.

PROMISES, PROMISES. On the home front, tensions are building around wage settlements and the budget. Workers equate democracy with the long-awaited opportunity to get economic benefits they have been flagrantly denied. And politicians are reluctant to say no, knowing that if the voters don't see economic progress reflected in their paychecks, there are plenty of politicians ready to promise the sky. That is the first step to increased spending, which soon is followed by inflation.

The next step, typically, is for inflation to be contained by allowing the currency to become overvalued. The obvious motivation is to stop a vicious cycle of price inflation, wage inflation, and currency depreciation. But the overvalued currency contains the seeds of a currency crisis. That translates into shorter horizons and higher interest rates to persuade investors

to stay on board. Those high interest rates turn get borrowers into trouble—insolvency then bankruptcy. Ultimately, the house cards collapse. When the country runs out of foreign exchange, real wages plummet.

An economic collapse of South Africa is not around the corner, of course. One insidious aspect of populism is that at the outset, it is strikingly successful. More purchasing power does create jobs and prosperity—inflation comes later. Those who warn of the risks are loudly contradicted by the facts and lose credibility. And while the voices of moderation and prudence are relegated to the sidelines, populists gain in popularity and power. And because at first, populist policies pay off, they are carried far beyond the reasonable point where they set the stage for collapse.

LATIN DISEASE. This populist cycle is well known from countless examples in Latin America, always accompanied by the claim that "this economy is different." If wages can be raised, the argument runs, there will be growth; inflation is not a problem, and exchange rates do not matter. All this is true at the outset, but none of it for long. A memorable example of this cycle could be seen in Peru in the 1980s, when President Alan García thought he could create prosperity with the stroke of a pen. He had one great year, one good one, and then an awesome crash.

South Africa could catch the Latin American disease. Reminding Pretoria of the pending risks is useful, but the coalition's skillful crafting of a conservative strategy attests to its understanding of the risk. Attention of South Africa's policymakers and the outside world must focus on a few specific points:

- The world economic community must water for populist challenges to the current economic plan and denounce them the moment they materialize.

- Public policy and international support must stress a massive investment effort in human capital—the only known source of sustained growth and prosperity. Here we are talking about an economy in which discrimination has kept the majority of the population out of fully productive lives.

- Open up the economy, which is riddled with protection, regulation, and inefficiency, freeing resources that can raise real wages without straining stability.

- Multilateral institutions must commit themselves to making South Africa's transition to democratic, pluralistic society a showcase success, just as for security reasons they are marshaled to help achieve reform and stabilization in Eastern Europe.

RUDI DORNBUSCH IS PROFESSOR OF ECONOMICS AT MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Park Avenue Ultra. A car so thoughtful, even its mirrors remember how you look.

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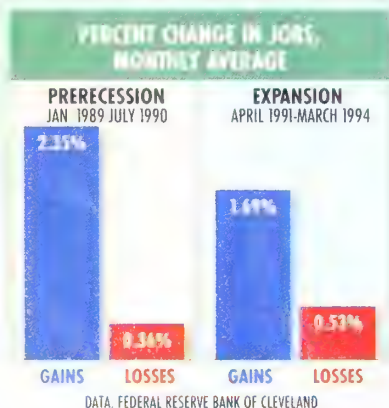
BY PAUL MAGNUSSEN

THE JOB MACHINE HASN'T BOUNCED BACK WITH THIS RECOVERY

If the current economic recovery had kept pace with previous expansions, 7 million more jobs would have been created by now. But three years into the recovery, employment has grown by just 5.4 million, or 4.8%, compared with an average gain of 11.2% by this stage in previous upturns. Among the commonly accepted explanations for the slow job growth: continued layoffs triggered by corporate restructuring, defense cutbacks, and disappointing exports.

But a different reason emerges from a study of the 10 most populous states by the Cleveland Federal Reserve's Kristin M. Roberts and Mark E. Schweit-

WHY JOB CREATION FALLS SHORT



zer: unusually weak job creation in expanding industries. This has failed to compensate for normal amounts of job losses stemming from cyclical factors, much less for any losses brought about by special factors. In fact, the rate of job losses, or "deletions," is almost back to prerecession levels, while the job "addition" rate hasn't bounced back. This phenomenon is all the more remarkable because the 10 states experienced widely differing rates of recession. Yet of the 10, only Massachusetts has restored its previous rate of job creation.

When the downturn ended in March, 1991, the monthly rate at which jobs were lost nationwide quickly dropped from its recession level of 1.64% to 0.53%—a bit higher than its prerecession level of 0.36%, but still a marked improvement. But except for Massachusetts, the corresponding job addition

rate hasn't yet rebounded to its prerecession rate of 2.35%.

In some states, such as Ohio, few industries are enjoying a recovery, and even those industries still aren't adding jobs as fast as in previous expansions. That matches the national trend. On the other hand, robust Massachusetts has had the opposite experience—more industries adding jobs faster than before. But in both these states, "the difference in employment growth is due to variations in their job addition rate, not their job deletion rate," say the authors.

The study notes that various theories account for the slow growth in job creation—including productivity gains and uncertainty about economic conditions. But the report speculates that increases in hiring and firing costs are the more likely explanation for why employers have been slow to create new positions.

NAFTA'S MIXED MESSAGE: OPEN THE FLOODGATES, BUT FILTER THE FLOW

Was the North American Free Trade Agreement an example of economic integration? No, it's more like "a continuation of a Hegelian dialectic over trade policy," say William C. Gruben of the Dallas Fed and John H. Welch, a vice-president at Lehman Brothers Inc. The trade pact reflects the synthesis of two clashing movements in trade policy—liberalization and protectionism. For example, parallel negotiations were conducted over environmental and labor-rights issues, and the result was trade restrictions, not liberalization. The pact also imposes stricter new criteria to determine North American content for autos and textiles.

NAFTA's biggest effect is in Mexico, where trade barriers had been highest. Yet barriers still remain: The agriculture, minerals, banking, textiles, and apparel industries there are all protected by long phase-in periods.

THE COLLEGE SHEEPSKIN WON'T KEEP MEN AS WARM AS THEY WANTED

One of the lessons from the 1980s was this: Stay in school. Real incomes of college graduates grew on average during the '80s, while incomes for those with only high school degrees plummeted.

But now there's evidence that wages of young male college-educated workers

fell just as fast as those of young male high school grads during the recession and post-recession years of the early 1990s. In a study published by the Economic Policy Institute, authors Lawrence Mishel and Jared Bernstein found younger male workers at most education levels particularly hard-hit by falling real wages.

From 1990 through 1993, real hourly wages for all high school grads fell by 3.1%, while for college grads, the drop was only a tad lower at 3%. The culprit for the college set include an end to the 1980s' white-collar hiring boom, the 1991 recession, and corporate restructuring. Only the 8% of the workforce with advanced or professional degrees escaped the trend.

But as the economic expansion continued over the past year, the available evidence shows that the education-wage gap has started to widen again. Adjusted for inflation, the wages and salaries of white-collar workers—who are mostly college-educated—have risen by 0.7% since June, 1993. By comparison, the earnings of blue-collar workers and service workers have risen by only 0.5% and 0.1%, respectively. The lesson learned: It's still a good idea to get a education.

GROWTH LOOKS GREAT —BUT ONLY IF YOU'RE NEARSIGHTED

Add the Congressional Budget Office to the list of forecasters raising growth estimates for the coming year. The nonpartisan CBO now figures gross domestic product will rise 4% this year and 3% in 1995—both more than it has calculated as recently as April. The happy result, say the forecasters, will be smaller-than-expected federal 1995 budget deficit accounting for just 2.3% of GDP, the lowest ratio since 1979. Inflation will remain mild, at 3.1%. Equipment purchases and consumer spending will keep steady, while net exports will add to growth in 1995.

But some disturbing signs remain for the long term. In 1996, the budget deficit, unemployment, and inflation all will begin to rise. The implication is a \$22 billion deficit in 1999, compared with \$213 billion anticipated only last April. Health-care spending on the poor aged and increasing federal interest costs are the prime suspects. There's worse news for the longer term: Unlike the Clinton Administration, the CBO forecasts that net interest costs as a percentage of GDP will continue to climb.



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THE CHILL IS FINALLY CREEPING INTO THE LABOR MARKETS

Until the August job numbers, there was one glaring inconsistency in the slowdown forecast expected by most economists. While other economic barometers were signaling a cooler pace of growth in the second half, readings from the labor market remained steamy.

Not anymore. U.S. industries added 179,000 workers to their payrolls in August, a good gain but far less than generally expected and well below the nearly 300,000-per-month pace of the previous three months (chart). Employees worked shorter hours. The unemployment rate refused to budge lower. And wages still show no signs that they are growing any faster now than they were a year ago.

What does it all mean? The evidence now seems clearer than ever that the economy is on a slower growth track than its 4% pace of the past year. As a result, many manufacturers will find it difficult to pass along higher raw-materials costs, many service industries will have to limit their hiring, and in general, any heavy inflation pressures are less likely to build.

The slowdown is primarily the result of the Federal Reserve's interest-rate hikes since February. Because of the long time, the impact of the Fed's seven-month tightening policy is only now beginning to be felt. Of course, one month's job numbers do not make a trend, but chances are rising that the Fed will not have to tighten policy any more for the rest of the year.

HOURS WORKED SLOWED SHARPLY

The August job numbers were far from weak, but last month's increase was the smallest since January. Overall, the report was consistent with other recent data, which have suggested that third-quarter growth in real gross domestic product could be 2% or less.

The key factor on that point is the tepid growth in total hours worked, which correlates strongly with real GDP growth. The workweek dipped from 34.7 hours in July to 34.5 hours. That decline, combined with the modest rise in payrolls, left overall work time thus far into the third quarter up at an annual rate of only 1.6% compared with the second quarter. That's far below the second quarter's 6.6% advance and half the 3.2% pace in the first quarter.

Service businesses, which have accounted for 85% of this year's job growth, added a solid 154,000 new jobs in August, but that gain was well below the 266,000 average for the prior three months.

Three industries, which make up only 20% of all service jobs, accounted for 73% of the month's increase: business services, health care, and social services. Retail employment was flat after two months of strong gains. And jobs in the hotel and recreation industries fell, probably related to the completion of the World Cup soccer matches in June and July.

A SOLID GAIN IN FACTORY PAYROLLS

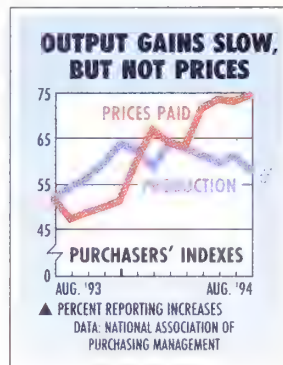
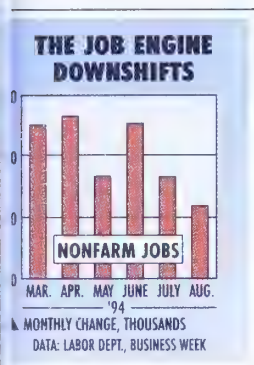
Among goods producers, construction employment dipped by 6,000, the first decline in more than a year. That clearly reflects the slowdown in housing this year and the fourth-quarter peak in construction activity generally. More job losses in construction seem likely this fall.

The only solid job gainer in August, compared with recent trends, was manufacturing. Factories put on 32,000 workers, bringing this year's total manufacturing gains to 135,000. Also, the factory workweek rose six minutes, to 42 hours, and overtime jumped 12 minutes, to 4.8 hours, an all-time high. All this means that industrial production in August posted a healthy advance.

However, factory activity is far from robust, as indicated by the August purchasing managers' index, which dipped to 56.2% from 57.8% in July. The index suggests that growth in manufacturing, while stout, was nonetheless the slowest in the past eight months.

At the same time, however, the purchasers said that the prices they pay for materials increased at the fastest rate in six years (chart). But don't be too quick to read an inflationary implication into that. Several purchasers were concerned about the rise, because they were unable to raise product prices to cover the added cost.

Inflation is even less of a worry now because the labor markets are not tight enough to generate much of a bidding war for workers. Indeed, the hiring surge this summer began to bring more people who had been discouraged at the prospects of finding a job into the job markets. The labor force jumped by 732,000 in August,



Business Outlook

which hardly suggests that labor markets are too tight.

Because of that surge, the jobless rate remained at 6.1% in August, about the same level since May. The labor force has room to grow a bit faster. During the past year, it has expanded by just 0.7%—far less than the 1.7% increase in the working-age population.

The changing mix of the unemployed also shows that people are being lured back into the labor force. A year ago, only 33.6% of job seekers were people reentering the workforce or looking for their first job. In August, 1994, however, reentrants and new entrants accounted for a large 42.9% of the unemployed.

As more people rejoin the workforce in coming months, the

jobless rate should continue to hover around 6%. That's above the point where a shrinking pool of available labor pushes up wages and inflation. Of course, labor shortages are already appearing in specific regions and professions. But in general, slack remains in the job market. And that's why wages are still unable to generate much of an upward trend.

LITTLE TROUBLE FINDING WORKERS

Hourly wages in the nonfarm sector rose 0.2% last month, to \$11.13. However, because of the shorter workweek, weekly pay fell 0.4%, to \$384. Over the past year, hourly pay has risen 2.5%—slower than its pace earlier in 1994. Growth in service wages has modulated around 2.5% for the past two years—about half its annual rate before the last recession.

On the surface, factory pay appears to be picking up (chart). It grew by 2.8% in the 12 months ended in August, faster than the 2.2% increase of a year ago. But this reflects the pickup in overtime. Excluding overtime, facto-

ry pay has risen just 2.1% this past year—unchanged from August, 1993, and below the growth that is found in service wages.

The meager gain in straight pay indicates that manufacturers are having little difficulty attracting new workers. Moreover, even with overtime pay, factory wages are rising below the trend in manufacturing productivity. That means unit labor costs—the major determinant of price pressures—are still falling in the factory sector.

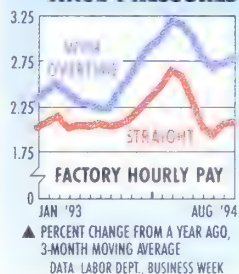
According to the Labor Dept.'s newly revised numbers, unit labor costs in manufacturing plummeted at an annual rate of 5.8% in the second quarter, reflecting a 1.6% drop in compensation and a 4.5% jump in productivity. Because of strong hiring in services, overall nonfarm productivity fell 2.5% last quarter, twice as much as originally reported. But during the past year, it is up 2.3%.

The slip in weekly pay reported in August does suggest that even with more jobs, personal income made little headway last month. As a result, consumers probably continued the spending slowdown they began in the spring.

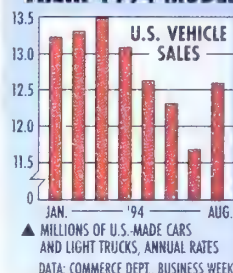
True, sales of motor vehicles bounced back in August. U.S.-made cars and light trucks sold at an annual rate of 12.6 million (chart). But sales had fallen in the previous four months. And consumers may have rushed to buy 1994 models before the 1995 models sporting heftier sticker prices appeared in showrooms. Sales for the quarter still should end up below the second-quarter level.

For now, auto makers are optimistic. A downshift in vehicle demand, however, would certainly cool this expansion's growth prospects. And as the tepid August labor data show, the economy's mercury has already fallen a few notches.

OVERTIME INFLATES WAGE PRESSURES



DEALERS CLEAR OUT THEIR 1994 MODELS



THE WEEK AHEAD

CONSUMER PRICE INDEX

Tuesday, Sept. 13, 8:30 a.m.

Consumer prices likely rose by 0.4% in August, says the median forecast of economists surveyed by MMS International, a unit of McGraw-Hill Inc. Higher energy costs led the increase, which would be the largest gain in 18 months. Excluding food and energy, prices likely increased 0.3%. In July, consumer prices rose 0.3% total, and 0.2% excluding food and fuel.

RETAIL SALES

Wednesday, Sept. 14, 8:30 a.m.

Retail sales probably rebounded in August, rising 0.5% after slipping 0.1% in

July. Better car sales helped, but back-to-school shopping also lifted receipts at clothing and department stores. Even so, because shoppers stayed home for much of the spring, August retail sales are likely to be only slightly higher than the level posted in March.

BUSINESS INVENTORIES

Thursday, Sept. 15, 10 a.m.

The MMS survey expects that inventories held at manufacturers, wholesalers, and retailers rose by 0.5% in July, on top of a 0.4% gain in June. They may have increased by even more, because factories have already reported a 0.9% jump in their July stock levels. Business sales, up 0.7% in June, probably fell by about

1.5% in July, as indicated by the already reported declines in retail sales and factory shipments.

INDUSTRIAL PRODUCTION

Friday, Sept. 16, 9:15 a.m.

Industrial output probably rose 0.5% in August, project the MMS economists. That's suggested by the gain in factory jobs and work time. Output advanced by 0.3% in July. Industrial activity is slowing, however. Even if the August forecast is correct, output would be rising at a 3.8% annual rate so far in the third quarter, slower than the 4.4% pace of the second quarter. Operating rates probably inched up to 84.1% in August from 83.9% in July.

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Top of the News

AUTOS

Jack A. Terhar can't wait for the new 1995 models to hit his suburban Denver Ford dealership. For years, the Japanese have nibbled at his sales and now command half the market for new cars in his region. But this fall, Ford's slick new Contour compact sedan will challenge vaunted models such as the Honda Accord. And a spruced-up Ford Explorer sport-utility vehicle should lure more customers out of their imports, helping Terhar recoup sales that once seemed lost for good to Japan.

Call it comeback No. 2 for Detroit. After two years of taking back market share from Japan, then stumbling and losing ground so far this year, Detroit is on a roll again. All told, domestic carmakers will move out 19 new or refurbished models in 1995. And they'll have the edge in almost every segment: Even with modest price hikes, domestic cars and trucks sell for an average \$2,000 to \$3,000 less than Japanese models. Detroit's new offerings "are going to take [market] share away from the Japanese big time," crows Chrysler Corp. President Robert A. Lutz. **FACELIFTS.** The big change lately: After lengthy model changeovers, factories are finally running full tilt again. Detroit's output has already snapped back to 1 million-plus vehicles per month from a July nadir of 475,000 units. With more vehicles making their way to dealers' lots, the domestics should recoup just over four points of market share, to reach nearly 75% of U.S. sales by year-end, estimates AutoPacific Inc. One of the biggest winners will likely be General Motors' struggling Chevrolet division, which is rolling out four new cars and trucks, including a much-needed redo of the midsize Lumina sedan and a sporty new version of its Cavalier.

Japanese companies, of course, aren't giving up. They argue that the Big Three may end up fighting for sales mainly with each other. New small sedans from Chrysler and Ford Motor Co., for instance, "will have an impact on all of us, but more so on the domestic manufacturers," says Richard Collier, senior vice-president at American Honda Motor Co. Meanwhile, the Japanese are using

attractive lease deals to help close the price gap on imports. For 1995, leasing will account for 25% of Toyota's total U.S. sales. And on popular U.S.-made models, the Japanese are barely raising prices. At Toyota, 60% of sales come from models produced at its Georgetown, Ky., plant. "That gets us out

of the dollar/yen problem," says J. David Illingworth, head of Toyota Div. at Toyota Motor Sales USA Inc. Toyota and Honda, also, are both targeting Detroit strongholds: Toyota with its big new Avalon sedan and Honda with its Odyssey minivan, due out in January.

On the surface, price hikes for 1995 seem relatively modest. On average, the Big Three are jacking up the stickers between 0.7% and 2.5% for 1995 models comparably equipped to last year's. But that's on top of midyear hikes on some

1994 models. Under pressure from the strong yen, Japanese carmakers have announced hikes ranging from 1.5% to 4%.

Let the buyer beware, though. Both sides will try to get away with some punishing increases, especially on made-in-Japan cars and hot-selling domestic-made

trucks and vans. Two examples: Infiniti's Q45 luxury sedan is up 10%, to \$52,400. And the price of the four-

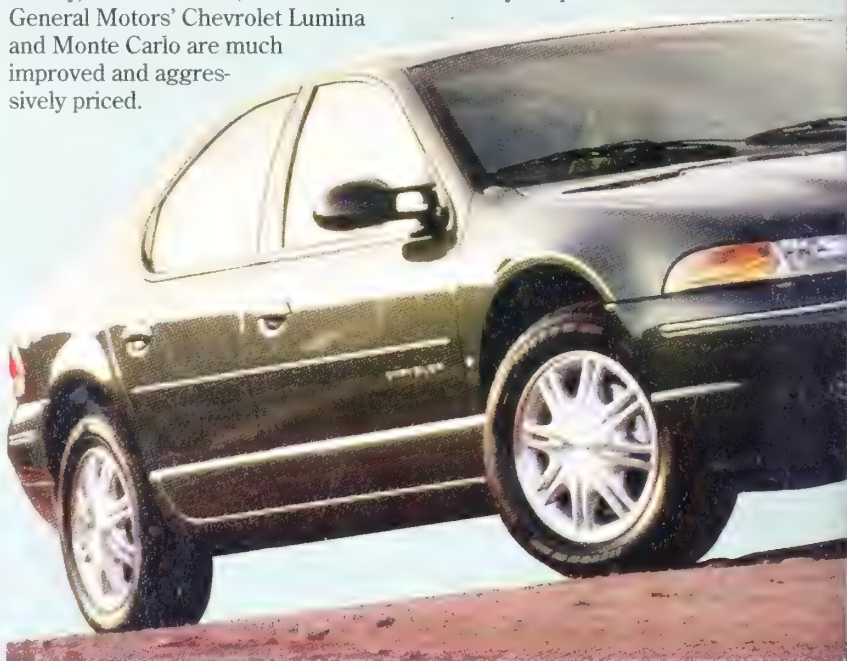
CARS! CARS! CARS! FROM COMPACTS TO MINIVANS, DETROIT IS PLAYING ITS HOTTEST HAND IN YEARS AGAINST JAPAN

FAMILY SEDANS

Ford's Contour and Mercury Mystique and Chrysler's Cirrus use sporty handling—plus a price advantage of up to \$7,000—to take aim at Japan's Toyota Camry, Honda Accord, and Nissan Altima. General Motors' Chevrolet Lumina and Monte Carlo are much improved and aggressively priced.

LARGE SEDANS

Can Japan take sales in a Detroit stronghold? The new six-passenger Toyota Avalon replaces the smaller Cressida, but is expected to have a steep base price that may keep sales modest.



heel-drive Jeep Grand Cherokee SE, a top seller in the red-hot sport-utility segment, has jumped 11%, to \$24,580.

As competition heats up, the biggest slowdown will come in the lucrative, 3 million-car market for family sedans. Ford's new entries, the Contour and its Mercury Mystique sibling, along with Chrysler's stylish Cirrus compact sedan and Dodge Stratus, represent Detroit's most credible new challenge in years to Japan's biggest U.S. stronghold. The new models come close to matching the refined performance and ergonomic interiors of such strong sellers as the Accord, Toyota Camry, and Nissan Altima—for as much as \$7,000 less.

Detroit will be working hard to lure shoppers who usually buy Japanese. To try to generate good word of mouth, Chrysler plans to loan Cirrus sedans free of charge to more than 5,000 young endsetters in 25 major cities. And Ford plans its biggest advertising blow-out in a decade to launch the Contour and Mystique—U.S. versions of its \$6 billion world car.

On the other flank, Detroit is tightening its stranglehold on the booming sport-utility market, adding plant capacity to build 500,000 more annually.

Chevy's new Blazer and its GMC sibling, Jimmy, are already showing up on dealer lots with stickers starting just above \$18,000—well below most rivals' prices. They're GM's most serious contenders yet in a market where profits can reach \$7,000 per vehicle, and next spring they'll be joined by new four-door versions of GM's big sport-utility models, the Chevy Tahoe and GMC Yukon. Ford, meanwhile, is giving the Explorer a facelift, standard dual air bags, and a cushier front suspension for 1995.

COSTLY STRATEGY? The market for high-priced sedans is also getting hyper-competitive. In low-end luxury cars, where prices cluster at about \$30,000, the all-new Mazda Millenia and Oldsmobile Aurora, as well as the redesigned Lincoln Continental, will likely spark price competition. That's already happening at the top end of the scale. Mercedes-Benz dramatically lowered prices on its modestly restyled S-class sedans to do battle with the all-new BMW 740i and new Lexus LS400 due this fall. The BMW and Lexus haven't been priced yet. But the price of Mercedes' S320 dropped \$4,700, to \$65,900.

Such price-cutting is spreading to more prosaic models, too. To keep

monthly payments down, for instance, Japanese carmakers are forking over subsidies on half of their lease deals, vs. one-third for U.S. carmakers, says Art Spinella, vice-president of CNW Marketing/Research in Bandon, Ore. Subsidies range from \$1,200 to \$1,500 for mid-size cars, he says. Plus, Japanese carmakers argue that their cars hold their value better than Detroit's, allowing them to keep payments low. But the leasing strategy could be costly if a slump knocks down used-car prices more than companies expect.

Japanese carmakers, meanwhile, are scurrying to cut costs on all their models. As Toyota redesigns its Camry for 1997, the company is aiming to squeeze out 20% of its cost, says AutoPacific analyst Christopher W. Cedergren. Belt-tightening is already showing up in U.S.-built models such as the Camry. For 1995, the base DX model's price dropped \$300 to \$16,400.

Such penny-pinching means Detroit must cool it on future price hikes. Otherwise, its sexy new models could lose their luster all too quickly.

By David Woodruff and Kathleen Kerwin in Detroit, with Larry Armstrong in Los Angeles



TOYOTA AVALON XLS



"ATTENTION-GRABBERS": FORD IS COUNTING ON THE CIRUS TO CLAIM SHARE IN FAMILY SEDANS

SPORT-UTILITY VEHICLES

GM is finally getting serious about this market with redesigned and refined versions of the compact Chevrolet Blazer and GMC Jimmy. Early next year, they will be joined by four-door versions of the larger Tahoe and Yukon. The highly popular Ford Explorer is also getting a revamp.



CHEVROLET BLAZER LT

LUXURY CARS

Fancy sport utilities continue to nab these sales. The big news: An all-new Lexus LS400 is coming. The big question: Will Toyota price it attractively enough to bolster slipping sales? Among the other tough competitors Lexus will face: a brand-new BMW 740i.

FORD WINDSTAR



MINIVANS

Ford's sleek Windstar came out this spring, but the action doesn't really start until early next year. Honda's new Odyssey minivan is due then, as is the first major redesign in a decade of Chrysler's best-selling Dodge Caravan and Plymouth Voyager.



BMW 740i

CUBA

ALMOST TASTING TRADE

U.S. companies want to be ready for post-embargo Cuba—whenever

Peter Blyth can see it already. Carlson Cos.' executive vice-president for development envisions a host of opportunities in Cuba for the Minneapolis-based travel and hospitality company. Perhaps a Radisson hotel on Cuba's famed Varadero beach, a TGI Friday's restaurant in Havana near the picturesque Malecón seawall, and a network of travel agencies and transportation services to serve the hordes of American visitors expected to flock to the Caribbean island once travel and trade are permitted. "If the embargo was lifted, we'd be there in a flash," says Blyth. "We believe it would be open house."

As images from Cuba's refugee crisis flood newspapers and television screens, many U.S. companies are exploring how doing business with the island nation might eventually affect their bottom lines. Despite an apparent stalemate over immigration issues and U.S. insistence that its 32-year-old trade embargo not be discussed until Cuba takes clear steps to adopt political and economic reforms, companies are dusting off plans to trade and, eventually, invest there.

EMBARGO HOLDUP. Estimates of business potential in Cuba are as varied as predictions of Fidel Castro's longevity. If the nation's battered economy adopts "a fundamental market-oriented restructuring," says Ernest H. Preeg of the Center for Strategic & International Studies, foreign exchange earnings could double to \$5.5 billion in two years. Donna Rich Kaplowitz, director of consultant Cuba Research Associates, estimates that U.S. trade could top \$1 billion in the first year after the embargo is lifted, with U.S. food and drug companies the first to benefit. Smith College economist Andrew Zimbalist puts investment potential at \$10 billion over five years.

Cuba has registered on U.S. corpo-



Some U.S. oil producers have already drawn up plans, so they can hit the fields running

rate radar as a potential market since the fall of the Berlin Wall in 1989. Interest waned when Congress tightened the embargo in 1992—but was rekindled this year with the lifting of the embargo against Vietnam and the Administration's relatively relaxed policies toward communist regimes, including China and North Korea.

Now a chorus from both sides of the political spectrum is urging the Clinton Administration to ease the Cuban embargo. Worsening economic conditions on the island, as well as the influx of investment from deep-pocketed foreign competitors (table), have added to the

pressure. Executive sense a change the offing, though they're unsure whether it will be U.S. policy or Cuba's leadership. "Something has to give," says Teo Bun, president of Cuba/USA Ventures Enterprises Inc. H. Miami-based company has joint-venture agreements with U.S. companies to pursue tourism, transportation, and manufacturing opportunities when the embargo is eased.

Despite U.S. travel restrictions, some American executives have visited the island for a first-hand look. Former Chrysler Corp. Chairman Lee A. Iacocca, who now has interests in the entertainment and gaming business, is the most recent notable, according to U.S. and Cuban sources. He spent five days in mid-July as the Cuban government guest, meeting with Castro and other high-ranking officials.

Iacocca didn't return calls seeking comment on his trip.

Until recently, U.S. traffic through Havana's José Martí Airport had been growing steadily. Representatives of Merck & Co. visited Cuba's biotechnology facilities twice last year; Johnson & Johnson executives made the trip in June. The nation's biotech industry manufactures 160 different pharmaceutical and medical products, many of them produced from U.S. producers, according to Julie M. Feinsilver, who has studied the business. American companies figure they could use Cuba's well-trained scientific workforce to augment domestic re-

CUBAN GOLD?

Cuban industries eyed by U.S. companies, and rivals already there

TOURISM

European, Canadian, and Jamaican companies, including Sol, Melia, and SuperClubs, already operate resorts

PETROLEUM

Total of France and others are exploring; Castrol Oil will produce and market refined products

MINING

Canada's Sherritt is buying nickel and upgrading plants; six companies are mining gold, other minerals

TELECOM

Mexican giant Grupo Damos has a deal valued at \$1.4 billion for 49% of Cuba's domestic phone company

arch and development, and Cuban manufacturing facilities could serve as a use for Latin American markets.

Another hot prospect: Oil. Some processors, such as Texaco Inc., have developed detailed plans to enter the market, post-embargo. "We're ready," says Stephen T. O'Farrell, vice-president of Texaco-Latin America/West Africa. "It's a matter of getting back into business under U.S. law." The company, which has a refinery in Cuba to Fidel Castro's astonishment, is interested both in refining oil again and in establishing a retail network on the island.

Companies must content themselves with the few areas that remain legal under the 1992 Cuban Democracy Act. Telecommunications suppliers, including MDS, MCI, and Sprint, have negotiated deals for long-distance service between the U.S. and Cuba. But U.S. authorities mixed approval for the deals this spring because of Cuba's proposed \$4.85 surcharge on operator-assisted calls. Officials with both LDDS and MCI say the issue may be resolved within weeks.

ACTIVE TRIPS. A growing raft of newsletters, consultants, and commissions are peddling off all the U.S.-Cuba interest. Two firms such as Miami's Holland and might have formed a Cuba task force to counsel clients. Reflecting the broad spectrum of views on investment, interest groups run the gamut from the U.S.-Cuba Trade & Economic Council, which is planning to host a luncheon in early October with Cuban Foreign Minister Roberto Robaina, to the U.S.-Cuba Business Council, which describes itself as a "post-embargo, post-Castro" group. What's missing, it appears, is the corollary will to force the issue of trade with Cuba publicly. Most businesses remain loath to speak out against the embargo for fear of angering some factions in the Cuban-American community—though Carlson's Blyth spoke in favor of lifting the sanctions in congressional hearings this spring and says the companies have had no reaction.

For most companies, Cuba is simply too small and too poor a market to risk political exposure until the end of the embargo is nearly certain. Although foreign companies are quickly establishing footholds in tourism, oil, and telecommunications, U.S. executives content themselves with furtive fact-finding trips. Cubans "have been hurt, and that pushes us to work against the embargo," says Roberto Solis, president of Miami-based Cuban-American Entrepreneurs Professionals. Solis and everyone else, however, seem doomed to wait out what promises to be a long diplomatic slog.

By Gail DeGeorge in Miami, with Ruth Carson in New York and Mark Lewyn in Washington

Commentary/by Douglas Harbrecht

BOB DOLE'S GATT ATTACK IS PURE POLITICS

To hear Senate Republican Minority Leader Bob Dole tell it, there is no rush for Congress to pass new world-trade rules this year. "Be careful and do the job right," intones the longtime free-trader. Hasty action would deprive the public of learning what's in the pact, he warns.

Wait a minute. Is Dole talking about the same deal that took seven years—spanning three Administrations—to negotiate? The pact that Congress has been haggling over since January? The accord that Dole and his fellow Republicans support in its basic contours? The answer is yes, yes, and yes.

JUST A PLOY. What's really behind Dole's high-minded rhetoric is a GOP ploy to go for President Clinton's political jugular. The party that stands for free trade would rather kill every Clinton-backed initiative this year than advance the cause of trade liberalization by approving a new General Agreement on Tariffs & Trade. It's a dangerous game that Dole and the GOP should abandon.

Just a few months ago, passage of a revised GATT and creation of a World Trade Organization to enforce it seemed assured. Now, the White House frets that the deal will crumble. For one thing, 117 other nations that have signed GATT are awaiting U.S. approval. Unless it comes, recalcitrants such as France and some developing nations may withdraw.

The WTO is the target of the same kind of scare tactics that opponents on the left and right used against the North American Free Trade Agreement. Conservative Patrick J. Buchanan excoriates the WTO as a U.N. of trade that will strip the U.S. of its national sovereignty. Ralph Nader says it will give foreigners the power to scuttle environmental and health laws.

Sound familiar? These were the

same false prophets who predicted that NAFTA would trigger the mass exodus of 6 million jobs to Mexico, permit the shipment of tainted food to the north, and depress wages in both countries. Instead, U.S.-Mexico trade has soared, border towns are booming, and Mexico just held the cleanest democratic election in its history.

Buchanan and Nader are tapping into a strain of American isolationism that one U.S. official concedes is

For Clinton, GATT's passage would cap the work of seven years and three Presidents

"damn good politics." It's also *déjà vu*. In 1948, when the first GATT was signed, Congress refused to back an international trade organization for fear it would constrain U.S. sovereignty. That left a toothless trade group that had only limited success trying to fend off protectionist practices.

The WTO is no U.N. It's simply a pact among nations to try to lower tariffs and trade barriers. As the world's largest free market, the U.S.

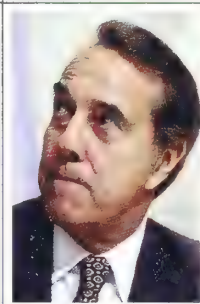
should be the panel's 800-pound gorilla, leading other nations against closed-trade practices. And just in case critics are right, Clinton accepted a House GOP provision that would let the U.S. pull out of the WTO after five years.

Lower tariffs in the new GATT rules will add \$1 trillion to the U.S. economy and create 2 million jobs in the next decade, the Organization for Economic Cooperation & Development estimates. But the most persuasive case for strengthening the world trading system is that there is no alternative. The global economy is changing so rapidly that without order, trading blocs will emerge—potentially prompting massive trade wars. With the most comprehensive trade pact hanging in the balance, more time is not what lawmakers need. To the contrary, time is running out.

Harbrecht covers trade wars for *BUSINESS WEEK* from Washington.



Dole's go-slow approach is one more attempt to kill anything Clinton wants





"I know they've passed the crime bill and that's good news, but look at how long that took. I think we should wait and see how the government makes that work before they take on anything else."

TOM SANDERS

'THEY SHOULD FORGET ABOUT IT AND MOVE ON'

In Pennsylvania, support for health reform has turned to tired skepticism

Harry and Louise, meet Gale and Rita. Gale Bailey, 75, and his wife have heard enough talk about health reform. Disillusioned by long and fruitless congressional debates, the Baileys sound a lot like the insurance industry's wary TV pitch-couple. "[Congress] should leave it alone," says Gale, a retired cost estimator for U.S. Steel. "All the government is going to do is mess things up for the small businessman and confuse things for everyone else." Adds Rita: "National health care would be too expensive."

Skepticism, doubt, and fear. The broad support that Americans evinced a year ago for bold experimentation in health care has dissolved, polls and anecdotal evidence show. A willingness to overhaul what were viewed as pressing social ills—spiraling medical costs and millions of uninsured Americans—has become steadfast acceptance of the status quo. The result: little popular support even for a much-diminished reform package.

That was quite clear from the talk at the 52nd annual Big Knob Fair over the Labor Day weekend in Beaver County, Pa. There, conversations turned easily from

prize cattle and pigs to Congress' mishandling of health reform. "They should forget about it and move on," argues Norma Couzens, 70. David Krall, 30, a part-time waiter who is covered by Medicaid, would rather see Washington focus on creating jobs. "I think health care is important, but I don't think [legislators] know what they want," he says.

LESS URGENCY. The talk of the Pennsylvania fairgrounds is the talk of the nation, experts say. Support for President Clinton's health reform peaked after his September, 1993, address on the plan. When the economy picked up, reform seemed less urgent an issue, says Karlyn H. Bowman, resident fellow at the American Enterprise Institute, a conservative think tank.

"Public concern began to grow with what they began to see as a very big and bureaucratic enterprise," Bowman says. She cites an Aug. 15-16 Gallup poll that found 47% of Americans would be relieved if Congress didn't pass a health bill, and 39% would be angry. In contrast, 56% of those polled said they would object if the Administration's crime bill ultimately failed.

Public disenchantment is all the more dramatic in



"I'd like to see some type of coverage. I don't have one steady employer. But I do work."

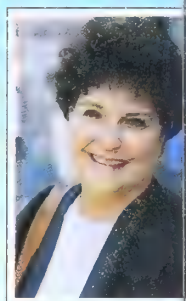
MARTIN LEE

would like to see reform but is concerned about what type of overhaul the government could implement. "I know they've passed the crime bill and that's good news, but look at how long that took," he says. "I think we should wait and see how the government makes that work before they take on anything else."

Others aren't so ambivalent: Those with little or no insurance still see health care as a big problem. Martin "Arkansas Troubadour" Lee spends his summers bringing his one-man-band act to state fairs in his converted van. A smoker for 37 years, Lee, 52, is uninsured. "I'd like to see some type of coverage. I don't have one steady employer. But I do work."

Likewise, Mary Anne Kownacki would welcome reform. Ten years ago, a public-transit accident left her with an injured back, a three-day hospital stay, and a \$10,000 hospital bill. With her minimum-wage cashier's job at a local pizza shop, Kownacki, 61, will be paying off the medical charges for "the rest of my life," she says. Even so, she has her doubts about what government can do for her: "If there's so much red tape now, I can't imagine how much red tape there'll be once they decide on a plan."

The truth is, people here don't think much of how the government has run it



"If there's so much tape now, I can't imagine how much tape there'll be once they decide on a plan."

MARY ANNE KOWNACKI

isting health programs, Medicare and Medicaid. Retiree Don Shaffer of Beaver Falls (Pa.) says he is constantly having to make copies of paid bills, Social Security numbers, and identification cards to clear up errors. "It's ridiculous. My life keeps getting bills for work she never had done. Medicare is the worst," he says. "How is the government going to run a comprehensive health-care sys-

tem when it can't even run its Medicare program?"

Still, candidates persist. Indeed, say some pollsters, the cynicism politicians encounter back home may spur them to push for action in Washington. At a Labor Day parade in Pittsburgh, Wofford told labor-union members that he isn't giving up on health coverage for uninsured children, ending insurance exclu-

sions for preexisting conditions and allowing the self-employed to write off the full cost of insurance on their taxes. "We can break the gridlock," the 68-year-old senator promised. "We broke it on the crime bill. We can break it on health care." Perhaps. The question is, will anyone care by the time they do?

By Keith L. Alexander in Pittsburgh with Mike McNamee in Washington

Commentary/by Mike McNamee

THE DEATH THROES OF HEALTH REFORM

When Congress returns to work on Sept. 12, Capitol Hill will ring with vows to deliver a prudent "downpayment" on health-care reform. The combination of stiff Republican opposition and growing public unease have doomed President Clinton's grand plan for universal health coverage. To recover, his allies will attempt to cobble together an incremental package built around insurance reforms and subsidized medical care or the poor.

But even this down-sized vision of reform faces treacherous prospects. With time quickly growing short before November's elections, Congress isn't likely to produce even a minimalist health bill. To pass, any plan must clear not just the usual partisan tangle but these hurdles: **■ Lonely at the center.** Although you'd never know it from their press clippings, moderate health reformers are a tiny bunch. Even the Senate's bipartisan Mainstream Coalition tops out at a mere 20 senators, and its plan is so finely balanced that any change made to pick up another Republican costs the group two Democrats—and vice versa.

The situation is even bleaker in the House. The Democrats' leaders, many of whom thought Clinton's original health plan too modest, will jump ship rather than fight for an incremental bill. Over in the GOP, many members backed a minimalist approach to counter the Democrats' expensive plans. But when moderate reform takes the spotlight, Republicans will take a hard look at what they've been sponsoring—and even insurance reform is "too rad-

ical for most Republicans," says a former GOP Hill aide.

■ Divide and conquer? Universal coverage didn't win many converts among the 85% of Americans who are already insured. But it did rally unions, consumer groups, and liberal activists to support Clinton. Trouble is,

business as usual, while those that do cover workers are hit with a maze of rules and taxes. Big employers charge that the Senate's mainstream plan would pressure companies to drop coverage and give workers cash instead. "It's a recipe for a meltdown of the employer-based system," warns

Richard I. Smith of the Association of Private Pension & Welfare Plans. Many businesses have yet to see a moderate plan they like.

■ Lethal infighting. Hill negotiators are trying to turn Clinton's double-decker bus into a minivan—but every interest group still wants a seat. Take doctors: Winning restrictions on managed-care plans "remains a top priority," says an American Medical Assn. spokesman. But that pits the docs against big busi-

ness, which sees managed care as its path to savings. Dozens of similar skirmishes could sink moderates' plans.

Two things could overcome these obstacles. Voters could threaten to punish incumbents who fail to deliver reform after two years of chest-thumping. Or President Clinton could start seriously twisting arms for one-step-at-a-time measures. But so far, neither is happening. Voters seem to have given up. And Clinton is "waiting to see what the discussions in the Senate can produce," says a top health aide. That's what the White House has been doing all year long—another reason why Clinton may end up with nothing to show for his No. 1 domestic priority.

McNamee covers health care.



moderate reform schemes—especially provisions that lack prescription drug coverage for the elderly and proposals to tax benefits—turn off the loyalists without winning any new converts. So even though Clinton seems amenable to compromise, his liberal allies are in no mood to sign on.

■ Business is still wary. Under moderate reforms, companies that don't provide insurance are allowed to continue

With the clock running on November's elections, Congress isn't likely to pass even a minimalist health bill

LOCK THE DOORS, IT'S EDS

Its wholesale talent raids are putting a strain on rival consulting firms

Michael Gleason has the management consulting business in a tizzy. For the past year, the executive in charge of the consulting arm at Electronic Data Systems has been blitzing McKinsey, Arthur D. Little, and other tony management consultants, spiriting away top talent. "We've been very aggressive," says Gleason, "and we will continue to be very aggressive."

No kidding. Since July, 1993, when EDS lured him away from rival Coopers & Lybrand, Gleason has built a practice of 1,380 professionals. And more top guns are signing on almost weekly: Joining EDS in September and October are John Pendlebury, a top managing partner at Coopers & Lybrand, who will head EDS' European practice, and Byram Johnston, a key Andersen Consulting partner (table). Gleason's goal, insiders say, is to have 5,000 to 8,000 professionals on staff worldwide in five years—far less than Andersen's 22,000 but enough to rank EDS among the top half-dozen consulting firms.

EDS' talent search is putting big strains on some competitors. Gleason has had a trio of head-hunting firms—Heidrick & Struggles, Lamalie Amrop International, and Paul R. Ray—scouring the market for months. "They are driving the price points for talent up," says Robert McIlhattan, a top partner at Ernst & Young's consulting practice. "They obviously are willing to lose money in the short term to gain market share." EDS says its consulting business is already in the black.

LEGAL DISPUTE. The raids even have thrown some rivals' business into turmoil. Each principal recruited by Gleason generally brings in 15 to 20 other people, often drawing heavily from his or her former firm. One example: In mid-June, when Leslie Buttorff left Stone & Webster Management Consultants Inc. to launch a global electric utilities practice at EDS, 10 of her colleagues left with

her. The raid cost the New York-based outfit nearly half of its Denver office and 10% of its entire consulting staff. "This is an extraordinarily aggressive program," says Stone & Webster President Richard B. Hieber, who says his company might have sued if Buttorff hadn't agreed to a settlement.

An EDS dispute with Arthur D. Little Inc. wasn't resolved so easily. After Heidrick recruited Charles D. Scales, ADL's aerospace practice leader, in January—

and eight other ADL consultants followed—Little filed a \$6 million lawsuit against EDS, Heidrick, and Scales. Even though ADL has since won a court order preventing future raids, the total number of its consultants working at EDS has climbed to around 20. Gleason says the additional defectors came to EDS without being recruited.

EUROCONSULTING. Gleason has stirred things up on college campuses as well, recruiting 95 MBAs and PhDs this year with plans to hire 250 more in 1994. One prominent rival says it lost its top-rated MBA graduate this year when EDS offered the student, with only three years of work experience, a \$95,000 base salary with a \$20,000 signing bonus and a fully loaded laptop computer thrown in. "Most of them are coming in not because we're handing out a lot more money," counters Gleason. "People want

"WE'VE BEEN VERY AGGRESSIVE": GLEASON AND A FEW OF HIS RECRUITS

to be in the start-up phase of a global consulting practice, and this is the only blank sheet of paper in town."

Can Gleason make it work? So far, the rapidly growing EDS group, which expects to hit about \$200 million in revenues this year, is an odd amalgam of consultants from vastly different corporate cultures. Two currently hot areas—change management and corporate reengineering—are headed by Gemini Consulting refugees. The consumer-goods practice, led by a former Price Waterhouse partner, while the communications industry group is run by an ex-Deloitte & Touche consultant. Aside from being hard to manage, such diversity may make it difficult for EDS to market itself coherently.

Still, Gleason figures that as the interest in corporate reengineering will provide plenty of room for yet another big consultancy to prosper. "If you were to put an end to all the reengineering in the U.S., you still wouldn't have enough consultants left to reengineer Europe," Gleason says. "If you moved them to Europe, you could probably keep them busy for five years."

So there's plenty more raiding to come from EDS. Whether Gleason pulls off his strategy or not, he is likely to remain in the doghouse of the consulting business for some time.

By John A. Byrne in New York



THE EDS GAME PLAN: RAIDS ON THE COMPETITION

Rivals that have lost key execs to EDS

ARTHUR D. LITTLE Early this year, EDS provoked a lawsuit when it nabbed Charles D. Scales, head of ADL's aerospace practice, and eight other ADL consultants. All told, ADL has lost about 20 consultants to EDS. EDS is fighting the suit.

COOPERS & LYBRAND John Pendlebury, a top managing partner in C&L's consulting arm, plans to leave in October to become managing director for EDS' European operations.

ANDERSEN CONSULTING On Sept. 1, former Andersen managing partner Byram Johnston departed to lead EDS' Asia Pacific practice from Sydney.

MCKINSEY 12-year veteran Andrew Power left in July to build up EDS' budding Boston-based health-care and insurance practice.



IBM'S NEW APTIVA HEAD FOR THE HOME

PC MAKERS ARE DREAMING OF A GREEN CHRISTMAS

Powerful new models and a price war could empty their warehouses

Aptiva, Ascenia, Spectria, Celebris. New models from Detroit? Try Silicon Valley. Those are just some of the new personal computers on the way out for what's shaping up to be a make-or-break fourth quarter for the PC business.

It's the computer industry's annual rivalry ritual: more power, lower prices. From IBM to Apple to Compaq to Packard Bell, big computer makers are flooding the market with new machines, fighting for crucial share of a market where growth has slowed from 30% to 10% a year. These PCs, based on Intel Pentium microprocessors, are far faster than their forebears of last year, and most are being souped up to handle advanced multimedia and communications applications. By yearend, for example, nearly every new PC will come with a CD-ROM drive as standard equipment.

LLING FAST. This year, the industry's heavyweights aim to sell their wares to consumers who will use them at home. And with prices dropping by the minute, buyers may bite. Sophisticated machines will be available at prices 40% lower than last year, says PaineWebber Inc. analyst Michael K. Kwatinetz. "It's going to be the biggest quarter in unit sales ever," he says.

Chip supplier Intel Corp. gets credit for the falling prices: It has driven down

chip costs by more than 40% this year. That means the average price of a loaded low-end Pentium PC should come in at about \$2,000. The result: PC sales during the fourth quarter—when the industry moves 30% of its units—should be up 13.8% from last year, to 13 million, estimates Sanford C. Bernstein & Co.

Meanwhile, technology is only getting better. Thanks to improved processing power and dazzling multimedia features, PC buyers can expect to run new games and "edutainment" software without jerky pictures and hissy sound—for the same price as a garden-variety PC of a few years ago. And new "plug and play" features will let novices easily hook up printers and such.

Suppliers are pulling out all the stops to grab their share of sales. Microsoft, Intel, and Compaq each say they will spend some \$100 million on consumer advertising and promotions through yearend. Apple Computer Inc. plans to run 900 spots on MTV. And insiders say IBM will pump some \$20 million into advertisements for its new Aptiva consumer PC line.

To try to stand out from one another, PC makers are tacking on little extras meant to entice home-computer buyers. Compaq Computer Corp.'s new Presario PCs, which are expected to be unveiled on Sept. 14, include a model with

TECHNO-SHOP 'TIL YOU DROP

The Big Three's fall personal-computer lineup:

IBM Its Aptiva consumer PCs come out on Sept. 19—equipped with CD-ROM, fax modem, and 40 software programs. Prices could range from \$1,200 to \$2,600. Due in October: new business PCs and a new ThinkPad notebook.

APPLE In early October, it introduces its first home models using the PowerPC chip. The five versions of the Macintosh Performa 6100 will come with CDs and software. Prices range from \$2,500 to \$2,800. For business, Apple also plans a new Power Mac 8100.

COMPAQ On Sept. 14, Compaq is expected to announce its new Presario home PCs, including models with integrated telephones and, possibly, TVs. A fully loaded multimedia model will start at \$1,500.

an attached monitor, CD-ROM drive, and a built-in telephone—all for less than \$1,500. IBM's Aptiva, scheduled for shipment on Sept. 19, will come complete with a staggering 40 software titles to go with its full complement of multimedia hardware and a three-year warranty. Packard Bell throws in AM/FM stereo and cable-ready TV. For its part, Apple will bring the PowerPC chip to the home market with Performa models priced from \$2,500 to \$2,800.

FOLD-OUT FUN. There are new machines for business in the works, too. Dell Computer Corp. plans to add communications and software to its new line of Latitude notebooks, and it will unveil even cheaper versions of its Pentium-powered desktops, now priced at less than \$2,000. And in October, IBM plans to introduce the IBM Personal Computer family—PCs meant to replace its ValuePoint and PS/2 lines—as well as a sub-notebook with a larger screen and a fold-out, full-size keyboard.

Can all of these companies try to sell essentially the same products to the same consumers without sparking a price war? Probably not. Already, bloated inventories have led Compaq, IBM, and Digital Equipment to declare 20% price cuts to clear their shelves of soon-to-be-obsolete models. And more discounts are coming: Hewlett-Packard Co., for one, will make cuts of as much as 20% on Sept. 19 on most of its desktop PCs—including versions the company just introduced in June and July. That could spell trouble for PC makers. But for buyers, it could portend a holiday season chock-full of bargains.

By Peter Burrows in Dallas, with Ira Sager in New York and bureau reports

MEDIA



IS TIME WARNER'S ZIGGING AND ZAGGING LEADING ANYWHERE?

Chairman Levin's interest in NBC has some observers wondering

Six months ago, Gerald M. Levin seemed under siege, vulnerable to a takeover by his largest shareholder, Seagram Co. Now, the chairman of Time Warner Inc. has taken the offensive: Levin's overture to General Electric about buying NBC is the latest in a flurry of moves that have left Time Warner watchers surprised, impressed, and more than a little puzzled.

In addition to the NBC talks, Levin recently offered \$1 billion to buy TeleCable Corp., the nation's 18th-largest cable operator—only to be outbid by cable titan John C. Malone. He selected the first outsider ever as editor-in-chief of Time Inc. And though the company denies it, executives close to Time Warner say he considered selling off two parts of the magazine division: Southern Progress Corp. and Sunset Publishing Corp. On top of that, Time Warner is still racing to open the first lane of the Information Highway in Orlando by late 1994.

Bankers and Time Warner insiders caution that the NBC talks may never result in a deal. Indeed, sources say a second, unidentified, bidder has entered the fray. But whatever the outcome, Levin's interest points up a

startling change in his strategy: After talking about interactive cable for two years, he now seems determined to plunge into plain-vanilla broadcasting. Says one executive close to Time Warner: "There are a bunch of people standing around the company scratching their heads." Levin declined comment.

PARAMOUNT CONCERN. Some of Levin's colleagues attribute his shift to shrewd opportunism. General Electric Co. finally seems ready to sell NBC Inc. And with federal TV regulations falling away, Warner Bros. Inc. is desperately trying to lock in distribution for its programs. The studio had even started its own network, called WB, which it still plans to launch in January. But the WB Network is lagging behind a rival network backed by Viacom Inc.'s Paramount Communications.

Owning NBC would help Levin avoid a uphill struggle with Paramount.

Most outsiders, though, haven't a clue as to how Time Warner would finance the deal. Levin has pledged \$4 billion to upgrade the company's cable system for interactive services by 1998. Bankers say NBC could cost \$2.5 billion, even without its TV stations, which Time Warner is prohibited from owning. What's more, the company is still shouldering \$13.9 billion in total debt. And despite rumors, insiders say an outright sale of the magazine division is unlikely. "The situation isn't bleak," says one executive, "but it is muddled."

One possibility: Levin could sell Time Warner's cable systems. "A lot of companies are reassessing their ability to

ON THE STANDS:
THE COMPANY IS
UNLIKELY TO SELL
OFF ITS MAGAZINE
DIVISION

grow in cable" in the wake of deregulation, says Michael J. Wolf, partner in charge of media at

Booz, Allen & Hamilton. On the other hand, insiders note that Levin bid aggressively for TeleCable when that company was auctioned off last month. TeleCommunications Inc. CEO Malone spirited it away with a last-minute offer of more than \$1 billion.

Insiders offer various explanations for Levin's zigzag course. Some say broadcasting is simply more attractive than cable right now. Levin once trumpeted the Orlando system as a test site for newfangled services. But technical glitches pushed back its launch from April to late 1994. And executives say consumers are lukewarm to the new offerings. Other colleagues say Levin merely reflects Time Warner's decentralized structure. "This isn't one company," says an insider. "This is five companies." For the moment, Warner Chief Robert A. Dalrymple has the boss's ear.

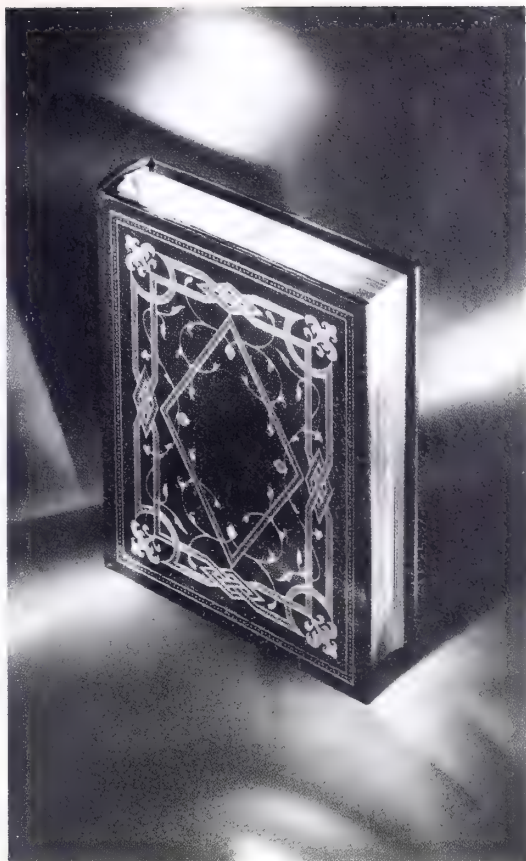
Finally, some think Levin has been emboldened after facing down Seagram, which owns 15% of Time Warner—without having to offer Seagram scion Edgar Bronfman Jr. a board seat. Certainly Levin is making waves elsewhere in the company. Some insiders think he committed apostasy by choosing

Norman Pearlstine, former managing editor of *The Wall Street Journal*, as editor-in-chief of Time Inc.

If an outsider can preside over the house that Lucie built, maybe buying NBC isn't a stretch. And anyway Levin may have another idea next month.

By Mark Landler in New York, with Ronald Grover in Los Angeles





EACH
CHAPTER
OF A GREAT WORK
MIGHT TELL
ITS OWN TALE,
BUT ITS TRUE
GREATNESS
LIES IN
ITS TOTALITY.



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A GHOULISH DEBATE OVER CASHING IN ON DEATH

Should buying life-insurance policies of the terminally ill be better regulated?

When Thomas J. Beranek, an Austin (Tex.) transportation manager with AIDS, was laid off in April, 1993, he didn't want the government to pay his mounting medical expenses. Told he had three years to live, Beranek sold his life-insurance policies—with a total benefit of \$58,262—and used the \$25,139 cash payment to cover doctors' bills, pay off debts, and travel. Without the settlements, Beranek says: "I'd be on the streets now or 100% on the public dole."

More and more terminally ill patients are arranging similar deals. Indeed, some 50 so-called viatical companies, which buy patients' life-insurance policies at discounts, have sprung up since 1988. This year, they are expected to purchase \$300 million in policies, according to the National Viatical Assn. (Viatical, derived from Latin, refers to a journey's provisions.)

The expansion has prompted scrutiny from all sides. State insurance regulators, citing rising complaints, fear that fraudulent companies could bilk ailing policyholders. Other critics, among them medical ethicists, raise questions about profiting from death. The Securities & Exchange Commission has signaled that it, too, is watching the transactions closely. In an Aug. 25 suit, the commission charged Life Partners Inc., a viatical company based in Waco, Tex., and its president with selling securities illegally. **HEFTY RETURNS.** In viatical settlements, ill patients sell their insurance policies for lump-sum cash payments that vary with life expectancy. The viatical company pays all subsequent premiums and ultimately collects the patient's death benefit. Typically, the transaction yields 10 to 20% return on investment for the company or its investor pool.



WITHOUT THE MONEY, SAYS BERANEK, "I'D BE ON THE STREETS"

Many terminally ill patients welcome such policy sales. Some 215 insurers nationwide provide a similar benefit that pays as much as 95% of a policy's face value—but usually only to patients within a year of death. Viatical companies offer a lower payout, typically up to 80%, but buy policies from sellers with as long as four years to live—though payouts are lower for patients with relatively longer to live.

Although they support some regulation, such as more disclosure from viatical companies and their investors, most patients fear that too many rules could cripple the industry. Regulators counter that without far-reaching guidelines, the largely self-policing industry is ripe for abuse. Take Credit Life Corp.

in Clearwater, Fla., and its affiliates. After receiving at least 50 complaints from patients who charged that Credit Life failed to make payments as promised, Florida officials shut the company down in May. Credit Life has since filed for bankruptcy. The California Insurance Dept. had already shuttered Credit Life's California branch, along with two other companies, for similar complaints. Former Credit Life President Torrey K. Cooper couldn't be reached.

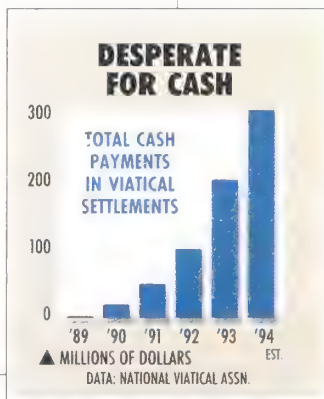
INSURER OR BROKER? The SEC's interest is different. It charges that Life Partners, like some other viatical companies, buys policies, then repackages and resells them to investors—in effect selling securities that do not meet disclosure laws. It wants the company to register as an issuer of securities. Life Partners President Brian D. Pardo, whose company has bought some 3,000 policies during the past four years, denies the charge. "The SEC is mischaracterizing the way Life Partners does business. Our clients are not buying stock in Life Partners. They are buying insurance policies," he says.

Beyond the legal arena, there are ethical concerns. Investors are often characterized as taking advantage of the terminally ill. "What does that say about society when we start to speculate in death?" asks the Reverend Patrick Norris, associate director of the Center for Health Care Ethics at St. Louis University. "Is there nothing we won't do for money?"

Investors see it differently. They contend that they are simply making an investment that also happens to help provide a dying person with a better quality of life. "The bottom line is, regardless of what we do, there's a good chance that [the patients] are not going to make it," says Texas State Representative Warren Chisum, who has invested some \$200,000 in policies through Life Partners. He recently earned a 23% return on one of the policies.

Beranek and other policy sellers agree. They say they've accepted that they may die soon and aren't concerned that someone might benefit from their death. "The reality is that many other investment opportunities are available to providers," says Beranek. "I was just fortunate that someone has allowed me to maintain my independence." Can ethicists and regulators be satisfied with such a response?

By Stephanie Anderson
Forest in Dallas



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MARKETING

THE COLA WARS GO TO COLLEGE

Universities are cleaning up by playing off Coke against Pepsi

In the face of funding cuts, what's a cash-parched university to do to raise money? Here's one idea that worked for Rutgers University: Have a Coke, and smile all the way to the bank.

On Aug. 31, Rutgers inked a \$10 million, 10-year contract giving Coca-Cola Co. exclusive rights to sell soft drinks and juices to the 48,000 students at New Brunswick and two other campuses in New Jersey. "This is one innovative way to help lessen the impact of cuts," Rutgers President Francis L. Lawrence said at a press conference announcing the pact. Under the deal, any campus-sponsored group has to sell Coke—and even campus restaurants and convenience stores that normally sell Pepsi will have to switch.

Rutgers is the latest example of a growing trend. Ever since Pennsylvania State University signed a beverage deal with Pepsi-Cola Co. in 1992 that is



BIG GUY ON CAMPUS: RUTGERS ISN'T FOR THE PEPSI GENERATION

expected to earn it \$14 million over 10 years, universities have been auctioning off rights to sell on their campuses in multiyear contracts. The University of Cincinnati, the University of Oregon, and others have also signed deals.

PYRRHIC VICTORY? In jousting for campus business, says Jesse Meyers, publisher of *Beverage Digest*, Coke and Pepsi run the risk of "whomping up the bidding until you know whoever is the winner is in fact the financial loser." Coke and Pepsi won't comment on the profitability of the pacts, but both admit they highly value having a strong franchise with

belonged to Pepsi—plus special promotional opportunities and the promise of exclusivity and got Coke and Pepsi to bid. Coke had to up Pepsi's offer of about \$7.5 million or lose its spot on campus.

Brad Choate, a Penn State associate vice-president, predicts that universities will cut "more and more" such deals. He says Penn State already has similar agreements with AT&T and bookseller Barnes & Noble Inc. The lesson: The great campus cola wars may soon broaden out to include all sorts of businesses.

By Maria Mallory in Atlanta

PEOPLE

'SKY' MAGARY PICKS A DOGFIGHT

As head of United's new low-cost shuttle, he'll be battling Southwest

During his 24 years in the airline business, Alan "Sky" Magary has earned a reputation as one of the sharpest executives around. During the early 1980s, Magary helped then-Chairman Stephen M. Wolf engineer a turnaround at troubled Republic Airlines Inc. Footrests and smoke-free domestic flights? Magary's ideas. "This is a man who understands the airline business, and everybody likes him. That's hard to do in this business," says Michael J. Boyd, consultant with Aviation Systems Research in Golden, Colo.

Now, Magary meets his toughest match. On Aug. 31, the erstwhile consultant was named president of The Shuttle by United, the new United Airlines Inc. carrier set to begin service in eight West Coast cities on Oct. 1. His goal: to wrest market share from such low-cost rivals as Southwest Airlines Co.

Already, The Shuttle is meeting turbulence. The union representing United's 18,000 flight attendants has refused to join the company's employee-ownership plan. Those workers won't be kicking in wage concessions and work-rule changes valued at \$416 million—savings that would help The Shuttle keep costs low. Meanwhile, Southwest has unveiled a nationwide promotion reducing Monday night fares to \$25 and threatened to invade United's long-haul markets. Continental Airlines Inc., too, launched a new fare promotion Sept. 7.

DECORATOR. Magary, appropriately and remarkably nicknamed Sky at birth, downplays the hurdles. "We're offering a product that's a real winner," he says. The Shuttle will generally match Southwest's fares—and, like Southwest, will focus on routes of less than 750 miles. Unlike Southwest, though, it will offer assigned seating and let travelers participate in United's popular frequent-flier program.

If customers don't bite, United could find itself chased from short-haul markets coast-to-coast—as it was in California

beginning in 1991, when it couldn't compete with Southwest's lower costs. Lower wages and flexible work rules should reduce The Shuttle's costs to 7.4¢ per available seat mile—only slightly higher than Southwest's. Still, Magary's first fight with Southwest, in the lucrative California market, could be fierce. Skeptics doubt United can outfox Southwest. "Only a deranged MBA could have thought this up," says consultant Boyd. United

executives hope loyal fliers in Los Angeles and San Francisco hubs will keep The Shuttle aloft. Then, it's off to fight for Chicago's Midway Airport, another Southwest stronghold.

Can Magary turn United into the low-cost provider it must become? Years ago, when redecorating Northwest's aging aircraft, he picked seat fabric with subtle patterns "to help disguise coffee spills," remem-

bers former Northwest maintenance executive Ben H. Lightfoot. Service and efficiency: That's what The Shuttle will need if it's going to play in Southwest CEO Herb Kelleher's backyard.

By Susan Chandler in Chicago



MAGARY: AIMING HIGH

THE SLAM-BAM TOURNAMENT

Now the PGA Tour rushed the Presidents Cup to beat out IMG



STAR GREG NORMAN IS ONE OF THE STARS IN THE U.S.-AGAINST-THE-WORLD CONTEST

When the inaugural Presidents Cup golf tournament tees off in Virginia on Sept. 16, it will have all the trappings of a marquee event: top players, three days of television coverage, a spanking new course—even a White House dinner for participants.

If things go well, few will know how much last-minute scrambling went into organizing the new tourney. The PGA Tour, the association of touring professionals that is the biggest organizer of golf events, hammered out the Presidents Cup in just six months—while in the midst of a management change. Why the rush? The PGA Tour wanted to beat its Cleveland-based nemesis International Management Group.

CORD YEAR. On the face of it, the PGA Tour would seem to have little to fear from rivals. Riding the wave of golf's growth, it will set records this year, with a projected \$58 million in prize money, \$70 million in revenue from TV rights, and \$82.5 million from sponsors and other sources.

But other events are eating into the PGA Tour's growth. Examples include *Ins Games*, made-for-TV contests in which four golf luminaries go head-to-head, and the *Shark Shootout*, a tournament hosted by Aussie pro Greg Norman. "The Presidents Cup is a rather transparent effort by the PGA Tour to grab part of the action," says a broadcast executive who has worked with the tour.

Fear finally drove PGA Tour officials to action. In February, they learned that IMG was teaming with Rupert Murdoch's British Sky Broadcasting, Star

TV, and other partners to launch a new U.S.-vs.-the-world golf event. If the PGA Tour didn't react, it would lose out to IMG's Mark H. McCormack. "It's our idea. The tour took it. That's fine," McCormack snaps.

In an effort to replicate the excitement of the Ryder Cup, the Presidents Cup will pit 12 top U.S. players against a dozen foreign foes, non-Europeans all. There are no prizes. The proceeds will go to charity. Tour officials say they had considered such an event for months and IMG's plans just spurred them to action. "There was a window that we felt might disappear by 1996," says new PGA Tour Commissioner Timothy W. Finchem. By mid-February, he had outlined a deal in which CBS and ESPN bought domestic-TV rights.

With an idea, a date, and a site—the new Robert Trent Jones Golf Club in Prince Williams County, Va.—the tour needed one more crucial element: players. "Corey Pavin was giving up a six-figure paycheck in order to make himself available to do something for free," says his agent, Roscoe "Rocky" Hambric Jr. While prior commitments kept some stars, including Ernie Els and Jumbo Ozaki away, the rosters are filled with such prominent players as Fred Couples, Greg Norman, and Vijay Singh.

U.S. team captain Hale Irwin says he was excited about being tapped, but one doubt nags him. "We have to look very carefully, and make sure we don't cannibalize the rest of the tour," he says. That's a worry. But with the likes of Murdoch and IMG circling the links, the PGA Tour had to act decisively.

By David Greising in Atlanta

LAWSUITS

COPYCATS ON A HOT TIN ROOF

P&G is aggressively suing those it says mimicks its brand names

Procter & Gamble has gone on the warpath. The target: copycats of its vaunted stable of brands. On Aug. 26, the day it acquired Giorgio Red perfume from Avon Products Inc., P&G sued Revlon Inc. for trademark infringement. P&G's aim: to keep Revlon from introducing "Charlie Red" in the U.S. Then, on Sept. 7, Procter went after Michigan drugstore operator F&M Distributors Inc. and private-label manufacturer Perrigo Co. for using packaging that P&G says apes its designs for Sure and Secret deodorants and other products. And those are just Procter's most recent actions: This year, the company has filed 13 such suits, vs. two or three annually in the past.

Why the upsurge? As P&G sees it, more companies are imitating its wares—or, at least, their packaging. And even though its profits are booming, Procter wants to counter the private-label competition that's aggravating brand-name marketers. In diapers, for instance, P&G in January sued private-label producer Paragon Trade Brands Inc., alleging infringement of two patents.

SEEING RED. Procter has had mixed success with its suits. It has settled a few recent actions in its favor, winning an end to some copycat package designs. But it also spent years warring with Kimberly-Clark Corp. over diaper technology, only to lose one key ruling—and, outsiders say, settle on unfavorable terms. Revlon and Paragon vigorously deny P&G's latest charges. Perrigo and F&M refuse to comment.

P&G still has a ways to go before it rivals America's most litigious defenders of corporate intellectual property. "They're sure as hell not Intel," says attorney Kenneth R. Adamo of Jones, Day, Reavis & Pogue, one of P&G's firms. But with P&G Chairman Edwin L. Artzt taking a personal interest in the topic, expect more action from P&G.

By Zachary Schiller in Cleveland



P&G IS SUING REVLO OVER THE NAME RED

EDITED BY KEITH H. HAMMONDS

NO SILVER LINING FROM STERLING DRUG

In its recent divestiture spree, Eastman Kodak has been getting surprisingly high prices for pieces of the Sterling Drug operation it acquired in 1988. Indeed, Kodak seems certain to bank far more than the \$5.1 billion it paid for the health-care concern. But is that enough to transform the much-derided Sterling deal into a winner? Probably not. So far, Kodak has reaped about \$4.6 billion for two former Sterling units (the clinical-diagnostics operation, sold on Sept. 6 to Johnson & Johnson, wasn't part of Sterling). Analysts estimate Kodak will get \$1.9

billion more for the two parts of household-products maker Lehn & Fink, plus perhaps \$300 million for Sterling's R&D building. That totals \$6.8 billion. But Sterling's profits didn't cover costs of servicing an extra \$5 billion in debt over six years, says Prudential Securities analyst Alex Henderson. His conclusion: Kodak "would have done better putting the money into T-bills."

WESTINGHOUSE COULD GET ZAPPED

Five Ohio and Pennsylvania utilities are charging Westinghouse Electric with selling defective generators for nuclear plants—and then covering up the problems for 25 years. At a trial beginning on Sept. 8 in U.S. District Court in Pittsburgh, the utilities, led by Duquesne Light, are suing Westinghouse for alleged racketeering. They claim that 88 other Westinghouse generators, with a life expectancy of 40 years, are cracking and corroding. Westinghouse acknowledges corrosion, but says parts warranties were for only five years. Of 12 similar suits, Westinghouse has settled five out of court.

DON'T BET ON A HILTON TAKEOVER

Is Hilton Hotels in play? A report by *USA Today* columnist Dan Dorfman that a group of unnamed buyers is eyeing the company fueled a 10% stock gain on Sept. 6. But cautious onlookers point to a history of false takeover starts, most notably a 1989 rumor frenzy that drove Hilton shares to \$115. They later fell back to \$26. The company, which denies it is in talks, is not apt to be sold soon. CEO Barron Hilton, who controls 24.5% of the stock, will probably delay a sale until the lodging-industry recovery blossoms. He may also wait until 1996, when new casino operations are expected to

HEADLINER

NOW, THAT'S A HEAVY ASSIGNMENT

She did it. In television ads first aired on Sept. 5, former CBS journalist Kathleen Sullivan took to a mountaintop to announce that she had lost 23 pounds—the gratifying result, ostensibly, of nine months of highly publicized dieting with the Weight Watchers program.

Sullivan, 41, stepped on the scales earlier in a Weight Watchers ad campaign starting in January. Without saying how much she actually weighed before and after, she boasts that she has dropped three dress sizes. The reward: Extension of her quarterly pitchwoman contract, which depended on her meeting the loss target. "It's a

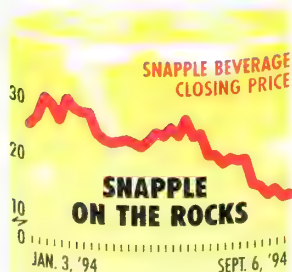
lot of pressure," she said in February of the deal. Fortunately, Sullivan has a day off. She'll start work on a show that will air on the Fox network next autumn.

Weight Watchers is relieved, too. The division of H.J. Heinz lost nearly \$15 million in the fiscal year ended Apr. 30. Analysts say a part of the problem was Sullivan's campaign began in the middle of a severe winter that kept people away from weight-loss centers. Now, after investing in direct marketing and customer database programs, analysts say the unit's profits should reach \$5 million in fiscal 1995.

By Keith Alexander



CLOSING BELL



It's not as though people have stopped drinking iced tea: This year, Snapple Beverage will likely ship 90 million cases of bottled teas and fruit drinks, up 60% from 1993. Nonetheless, Snapple's inventories have ballooned, possibly because the company overestimated demand. Margins have slipped, too—hinting at price softness. In late August, a slew of analysts downgraded the stock, some fretting about Coca-Cola's new Fruitopia concoctions. Down plunged Snapple shares. And on Sept. 1, Wheat First Butcher & Singer analyst John Maxwell also cut his rating after Snapple refused to provide inventories or shipment estimates. Maxwell expects the company to take an earnings charge.

add \$150 million to Hilton's cash flow—boosting its market value to \$100 a share, analysts say, from \$64.

WHO'S BUYING BOEING'S NEW 737s?

No airline will yet admit to ordering one, but Boeing will start development anyway of a larger version of its popular 737. Boeing says four undisclosed customers have "committed to order" more than 40 of the planes, dubbed the 737-800, which feature new engines and wings, more range, and a fuselage longer than the 737-400 it replaces. The almost-orders are worth \$1.6 billion.

JIMMY CARTER: NO HIT WITH BALLPLAYERS

Don't look for the White House to end the four-week-old baseball strike. The Clinton Administration has passed on a suggestion from a

Federal Mediation & Conciliation Service official that it appoint Jimmy Carter or former Secretary of State George Shultz to bring the disputed binding arbitration. The to FMCS umpire nixed the proposal, too. "It doesn't make sense at this time," says FMCS Director John Wells. The ballplayers aren't exactly distraught by the decision. "What does Jimmy Carter know about the industry baseball?" sniffs Major League Baseball Players Association spokesman Gene Orza.

ET CETERA...

- The Haft saga persists. Patriarch Herbert was fired from the family property unit.
- American Express unveiled the True Grace Card, with a 25-day interest-free period.
- Kidder Peabody named Michael Madden to head its "global origination" effort.
- Chicago's new name: Windows 95. Why? Microsoft won't ship it until next year.



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Business

CLINTON IS STREAMLINING GOVERNMENT— BUT VOTERS MAY NOT CARE

Efficient government" strikes voters as an oxymoron, and for good reason. From Richard Nixon's Ash Commission to Ronald Reagan's Grace Report, Presidents have declared war on bureaucracy for decades, yet the federal government grows only more bloated. So skepticism will be in order on Sept. 14 when President Clinton releases a one-year anniversary "Reinventing Government" report and boasts that sweeping reform is at hand.

But only cynics would dismiss the ReGo effort headed by Vice-President Al Gore as worthless. The Administration actually has made a promising start. Agencies insist they're delivering services more efficiently, from distributing food stamps electronically to shortening approval time for government mortgage insurance from five months to five days. The Administration's bottom line: It's on track toward a five-year goal to save \$108 billion and is halfway toward downsizing U.S. payrolls by 272,000, in part by copying private-sector buyouts.

Government reform was a key element of Clinton's campaign as a New Democrat. To keep his pledge, he "needs to convince Americans that he can fix government," says Al From, president of the centrist Democratic Leadership Council. That's why the president has a full-time "reinvention" staff and why many agencies have their own ReGo czars—all trying to improve customer (read: taxpayer) satisfaction. Gore even awards tiny hamlets to those who bust up bureaucracy.

By the end of September, agencies are supposed to meet new performance standards. The Internal Revenue Service, for example, must provide refunds within 14 days to taxpayers who file electronically, and the U.S. Geological Survey will try to fill requests for maps within two days, rather than the current six weeks.

There's more. Under a new governmentwide procurement law, the Pentagon is eliminating onerous paperwork requirements for vendors, saving billions in the purchase of commercial products. The Interior Dept. has transferred 300 Bureau of Reclamation employees from Denver headquarters to area offices to work more closely with customers in the field. Mortgage companies can expect to save \$4 million a year because the Housing & Urban Development Dept. has automated the processing of FHA insurance applications. The Agriculture Dept. is consolidating field offices from 3,700 to 2,500 so farmers won't have to traipse to different locations for various services.

SACRED COWS. But change isn't coming easily. Reform faces trouble from congressional barons who protect pet agencies. The House barred personnel cuts at the Veterans Health Administration, for example. And conservatives will try to block civil-service reforms that give unions job-security concessions in return for flexible work rules.

Anticipating such opposition, the ReGo-nauts decided at the outset to steer clear of major reorganizations,

such as consolidating 100-plus job-training programs. Useless sacred cows such as the Rural Electrification Administration and the Interstate Commerce Commission will be spared, too.

But the decision to reinvent existing services rather than reinvent unwanted ones may mean Clinton won't get the big political payoff he seeks. Voters won't thank him for improving programs they don't want. "It's like making the buggy-whip factory more competitive," scoffs Scott A. Hodge, an analyst at the conservative Heritage Foundation. "They'll just find ways to waste our money more efficiently." With a voter mind-set like that, Bill Clinton and Al Gore shouldn't be surprised if their good deeds go unrewarded in the voting booth.

By Susan B. Garland, with Amy Barrett



SHOW TIME: GORE DOES LETTERMAN

CAPITAL WRAPUP

POLITICS

Former Housing & Urban Development Secretary Jack Kemp is hinting to top Republicans that he may sit out the '96 GOP Presidential race. Kemp, who lags far behind Senate Minority Leader Bob Dole in early polls, has said he is having too much fun making money on the lecture circuit to give it up for the campaign. Republican insiders say the ex-quarterback may change signals, but they're betting he stays on the sidelines. One sign of a no-go: Kemp has been slow to assemble a campaign team, while Dole, ex-Defense Secretary Dick Cheney, former Tennessee Governor Lamar Alexander,

and Texas Senator Phil Gramm are recruiting top talent. Another omen: Kemp plans to pass up the Christian Coalition's September conclave.

LEGAL REFORM

The Clintonites are about to launch civil-justice reforms—but they'll be meek. With two lawyers in the First Family, the White House wants to avoid the kind of controversy the Bush Administration stirred with attacks on the litigation explosion. Instead, the Justice Dept. plans to try to clear crowded federal court dockets by using arbitration to resolve disputes. Another idea: creating special courts for family and business conflicts.

THE ADMINISTRATION

President Clinton may be supporting anticrime legislation, welfare reform, and immigration curbs to woo moderate voters, but his appointments appeal to old-fashioned Democrats. The Prez has tapped U.S. Judge Abner J. Mikva, a liberal ex-congressman from Illinois, as his new chief counsel. Robert Greenstein, head of the leftish Center on Budget & Policy Priorities, is in line for deputy director of the Office of Management & Budget. And a front-runner for a seat on the Federal Trade Commission is Georgetown University law professor Robert Pitofsky, a liberal antitrust expert.

EXPORTS: 'THIS SHOW HAS LEGS'

The U.S. boom appears to be gaining new momentum

Robert T. Pando, chairman of Lynch Machinery Inc., is ecstatic. Orders for the Bainbridge (Ga.) company's picture-tube-manufacturing equipment hit more than \$30 million last month. That's a record backlog for the 80-year-old outfit, which had sales of just \$8 million for all of last year. The more remarkable statistic, though, is that 90% of the new orders are destined for China and other overseas customers. "This show has legs," Pando exults. "We're looking at markets that can't get televisions fast enough."

He's not alone. U.S. exports of goods and services hit an all-time high of \$58.2 billion in June, according to the latest figures from the Commerce Dept. (chart). One reason is that economic expansions are finally under way in

AT A PICTURE-TUBE-MACHINERY PLANT IN GEORGIA: GLOBAL EXPANSION HAS LED TO BRISK SALES OF U.S. GOODS

all major industrial countries. Add in a weak U.S. dollar, the Clinton Administration's relaxation of high-tech licensing controls, and the North American Free Trade Agreement, and you have a U.S. export boom that may be gaining momentum after it seemed to be running out of gas earlier this year.

The favorable trend is prompting the Commerce Dept. to redraw its export outlook for the rest of the year. This past January, the agency expected exports would fail to match a puny 4% rise in 1993. Now, it expects a jump of 8%, to \$493 billion. Although no one sees a return to the double-digit growth of the late 1980s, "things are picking

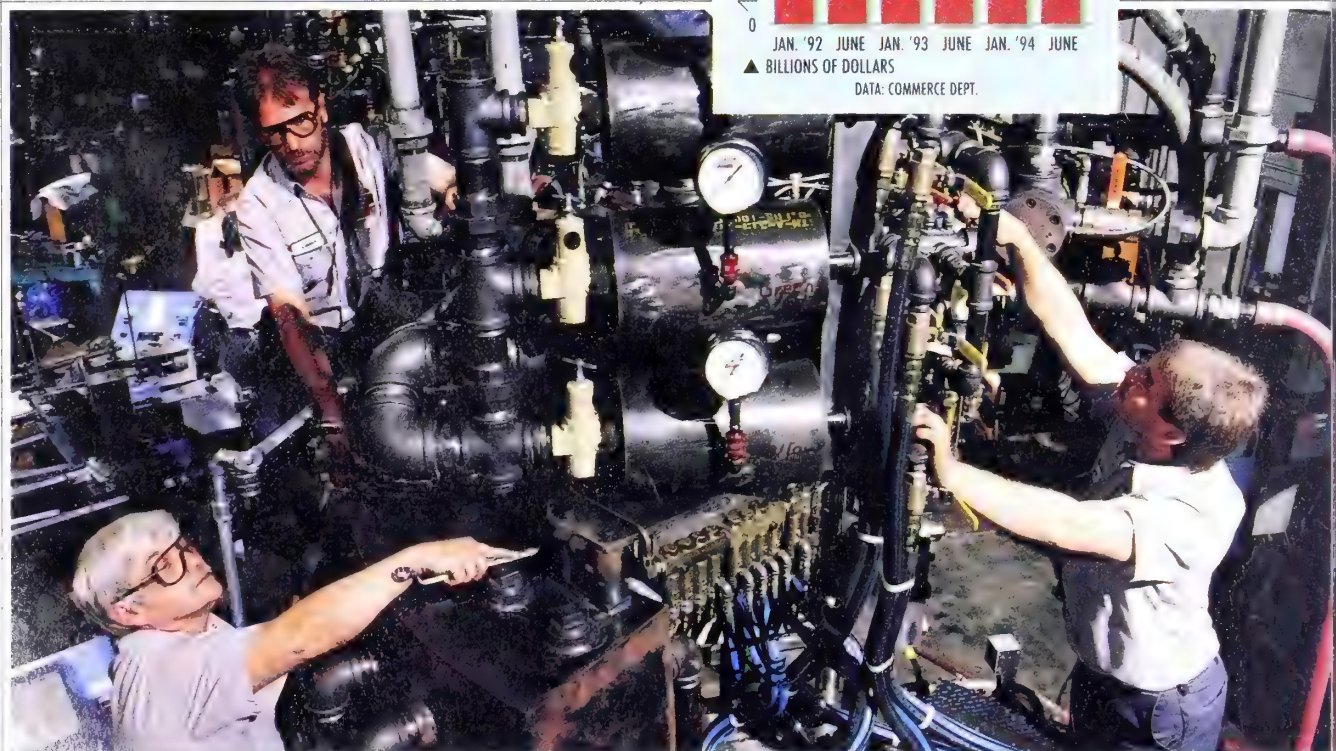
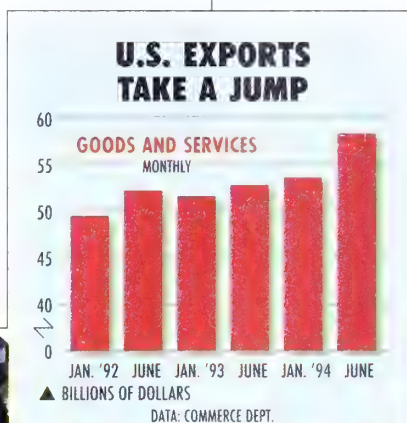
up more quickly and strongly around the world than we originally thought," says John E. Jelacic, senior international economist at Commerce.

There is one dark cloud in this silver lining. Imports continue to surge, too, as the strong U.S. economic expansion sucks in products and services from abroad (box). And a stronger yen will make Japanese autos and electronics more expensive to U.S. consumers. As a result, the U.S. is unlikely to reduce its annual trade deficit much below \$30 billion before 1996 at the earliest.

ROOM FOR GROWTH. But for exports, the outlook appears promising as far as the eye can see. Even the very companies that were once symbols of America's failure to compete, the Big Three auto makers, are taking part. In the first seven months of this year, Ford Motor Co.'s exports were up 90% from 1993, to 66,198, with the greatest increase in Mexico. Take the Escort. Ford expects to ship 50,000 of them south of

the end of next year.

Ford also is looking to the East. It has added the Mustang and the right-hand-drive Probe to its Taurus and Explorer lineups in Japanese showrooms—a sign of the Big Three's belated determination to



or cars for foreign markets. "Japanese cars are getting boring," crows Koichi Suzuki, who heads Ford Motor Co. (Japan). His proof: Ford's exports to Japan in the first half were up 147%, from 2,742 last year to 6,765. It's a small number, but it's clear that there is room for big growth.

General Motors Corp. is also gearing up. Beginning in January, 1996, the company plans to ship 20,000 Chevrolet Cavaliers a year to Japan for sale as Toyota. Chrysler Corp. saw its overseas car sales soar 34%, to 63,517, in the first six months of 1994. On Sept. 2, Chrysler President Robert A. Lutz said the No. 3 automaker plans an aggressive strategy in South America, one of the fastest-growing auto markets in the world.

The computer industry is seeing a resurgence overseas thanks to a dollar hovering around 100 yen. International orders for Hewlett-Packard Co. grew 15% in the quarter ending July 31, outpacing its domestic sale rise of 24%. PCs and printers are the driving force behind the 15% sales increase in the red-hot Asian markets, says HP Chief Economist Richard C. O'Brien.

DESTINATION. U.S. machine-tool manufacturers expect exports to break their 1992 record of \$1.2 billion. China has become the second-largest foreign market for U.S. machine tools—only Canada is a larger customer, according to Commerce. China is "our biggest export market," says Robert E. Agan, CEO of Horseheads (N.Y.)-based Hardinge Brothers Inc., which makes lathes.

Mexico is another hot destination, even for smaller exporters. NAFTA's passage "seems to have raised the whole awareness for smaller business of a broader market out there," says Sandra Kibbey, senior vice-president for small-business services at KeyCorp bank holding company, based in Albany, N.Y. One client, Gabriel Electronics Inc. in Norborough, Me., predicts exports of microwave antennas will increase from 10% of its total sales to 50% in coming years.

The sheer number of these smaller exporters seems to guarantee continued gains. American Power Conversion Corp., a West Kingston (R.I.) maker of devices that protect computers from power surges, has experienced 100% gains in former Soviet markets, while Chadwick International Inc. in Fairfax, Va., peddles its housing units throughout the tricky markets of North America. With such an array of exports chugging on, U.S. companies are proving doubters all wrong. Just ask Robert Laddo down there in Georgia.

By Douglas Harbrecht in Washington, James B. Treece in Detroit, Zachary Miller in Cleveland, and bureau reports

WHY THE TRADE GAP IS SO STUBBORN



You might think the U.S., after running up trade deficits for more than a decade, was ready to turn the corner. After all, foreign customers are hauling out their checkbooks to buy U.S. capital goods—from jumbo jets to machine tools to computers. Moreover, American manufacturers and service providers are enjoying the low inflation and higher productivity brought on by an investment boom. So, with the end of an export lull at hand, why is the U.S. trade imbalance still growing?

The reasons are many and complex. For one, imports will keep growing faster than exports because Americans aren't willing to give up luxury cars from Japan and Germany, consumer electronics from Singapore, or winter tomatoes from Mexico. As U.S. manufacturers gear up to crack international markets, they also are absorbing larger quantities of equipment and components from abroad. Many simply rely on manufacturing at their offshore subsidiaries, rather than shipping from home. "We are never going to bring all that production back to America," says Stephen Cooney, an economist at the National Association of Manufacturers.

The traditional pattern is that imports increase during any U.S. economic expansion. And when the rest of the industrial world is in a slump, as has been the case this decade, foreigners will buy fewer U.S. exports such as Caterpillar tractors and General Electric turbines. The result of those

A LEXUS SC400: AMERICA'S APPETITE FOR JAPANESE CARS, ASIAN ELECTRONICS, AND MEXICAN PRODUCE REMAINS FIERCE

two forces has been a wider trade gap.

Now, even though a pickup in growth abroad has boosted U.S. exports, the trade deficit is still likely to

increase, at least over the short term. "Imports have been growing as a share of the economy for 45 years now, and that's a tough situation to turn around," says Michael P. Niemira, an economist at Mitsubishi Bank Ltd. in New York. Another explanation for the rise: the increasing number of foreign-owned factories in the U.S. that merely assemble parts imported from abroad.

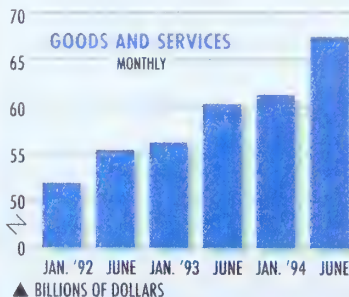
INFLATION CHECK. Many economists also say Americans' preference for consumption over savings makes tackling the trade deficit harder. Only by doubling the U.S. savings rate and cutting the budget deficit, thereby reducing consumption, can the trade deficit be eliminated, they believe. "There are barriers to U.S. goods in places like Japan, but until we get our savings and investment mix in order, nothing will work," says Daniel F. Burton, president of the Council on Competitiveness, a Washington think tank.

Even though an immediate turnaround in the U.S. trade balance isn't in the cards, some economists say that's not all bad. For one thing, when the next U.S. recession hits, layoffs will

be more concentrated among foreign suppliers than among U.S. companies. And globalization has helped keep inflation in check, since neither American manufacturers nor employees can safely demand higher prices or wages.

By Paul Magnusson in Washington

U.S. IMPORTS KEEP CLIMBING



QUEBEC



WILL QUEBEC REALLY DO IT THIS TIME?

If the Parti Québécois wins, it will move toward autonomy

The town of Repentigny hardly looks like the setting for a revolution. Except for its French-language signs, the community of some 35,000 just north of Montreal looks like any other North American suburb, its quiet streets lined with well-kept homes. But one recent sultry evening, Repentigny gave Jacques Parizeau's campaign to break up Canada a rousing reception. If his Parti Québécois is elected in Quebec's Sept. 12 elections, Parizeau told a crowd packed into a school cafeteria, he will ask voters "Où ou Non?" whether they want to become a sovereign country. At that, the crowd erupted, waving Quebec fleur-de-lis flags and chanting: "Parizeau! Parizeau! Parizeau!"

Rallies such as that one help explain why the election promises to be a watershed in Canada's long-running debate over whether it can survive as a united country. Even skeptics, fed up with per-

ennial debates about Canada's constitution, agree that Quebec is poised to settle the issue for years to come. The reason: If the PQ scores a decisive victory over the ruling Liberals as expected, they will be in a stronger position than ever before to achieve their vision of independence.

BATTLE PLAN. Parizeau and his top lieutenants have developed a battle plan for winning a referendum on sovereignty. Following a "oui" vote, Quebec would seek to become a nation of 7 million people with an economy the size of Denmark's. Despite their rhetoric, the separatists don't envision total independence because they would want to use Canada's currency and maintain an "economic association" with English Canada.

But any moves toward greater decision-making autonomy are bound to trigger new acrimony within the country. The rest of normally placid Canada could

face new concerns over its ability to remain whole with, for example, its Maritime provinces geographically cut off. "There are no guarantees that there will be only one new country" north of the U.S. border, predicts Gordon Gibson, author of a new book *Plan B: The Future of the Rest of Canada*.

Because Canada, the largest U.S. trading partner, its financial poses challenges to Washington, already coping with hemispheric brushfires in Haiti and Cuba. The Clinton Administration has stayed out of the Canadian debate but after a "yes" vote in Quebec, "the U.S. will have to get involved," says Joseph Jockel, director of the Canada project at the Center for Strategic & International Studies in Washington.

At some point, the U.S. would have to decide whether to recognize Quebec

THE PQ ENVISIONS JOINING NATO AND NAFTA, WHILE KEEPING CANADA'S CURRENCY

which could prove explosive among English Canadians. It also would have to decide on what terms to allow Quebec into the North American Free Trade Agreement (NAFTA). Both Quebec and other parts of Canada, meanwhile, would pay an economic penalty in terms of employment, and the financial markets could pound the Canadian dollar. Quebec Premier Daniel Johnson, who holds a Harvard University MBA, has been warning that "the political uncertainty Parizeau would create is simply anathema to economic improvement."

But voters don't seem to be listening. A poll published by *The Globe and Mail* on Sept. 6 showed Parizeau holds a 49% to 38% edge over Johnson, the widest of the campaign. Most of Quebec's French-speaking voters agree with Pier Sante Volpato, 40, a Bell Canada engineer who reasons: "After nine years of Liberal rule, it's time for a change."

Winning the referendum would be more difficult. A recent poll by CRI Inc., one of Quebec's leading pollsters, found only 45% of Quebecers support



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"sovereignty." Polls such as that have helped calm the markets, which earlier this summer sent the Canadian dollar to a six-year low of under 72¢.

But this is just the calm before the storm that's likely if the PQ wins. Within weeks of taking power, Parizeau, 64, says he will ask the National Assembly to pass a "solemn declaration stating Quebec's wish" to become a sovereign nation. Once the PQ is in power, "they will have a big impact on the agenda in Canada," says Claude Gauthier, CROP's director of research. "The margin [on the referendum] will then narrow, and there is a chance that it could even pass."

If voters approved, Quebec would claim authority to adopt all laws and treaties and collect all taxes. The new nation would seek to join the U.N. and NATO and have its own armed forces. At the same time, because Quebec exports about half of its \$117 billion gross domestic product, it would try to continue business as usual with its two key partners: the rest of Canada and the U.S.

It may sound far-fetched, but even Guy Saint-Pierre, CEO of SNC-Lavalin Inc., Canada's largest engineering company and a committed federalist, says: "I don't question whether independence is feasible." That's because of the progress in creating an economy run by French-speaking Quebecers. Today, some two-thirds of Quebecers work for companies controlled by Francophones, up from under half in the early 1960s. Those Quebec-based multinationals include such giants as Bombardier Inc., North America's largest maker of transportation equipment, and SNC-Lavalin.

DEADLOCK. Despite this increased clout, Quebec's efforts to obtain greater political powers within Canada have been repeatedly thwarted, creating enormous frustration in Quebec. Even Claude Castonguay, a prominent Montreal banker, recently complained that "English-speaking Canada refuses to make a place for



THE PQ'S PARIZEAU AND LIBERAL PREMIER JOHNSON: ONLY 18% OF QUEBECKERS EXPRESS SATISFACTION WITH THE STATUS QUO



Quebec at the heart of Canada." Such sentiments are widely shared: CROP polls show that only 18% of Quebecers feel the status quo is acceptable.

But at the same time they want more powers, most Quebecers are torn by the prospect of a complete departure from Canada. What they really want, says Jean-Marc Leger, a leading Mon-

David Cameron, a Quebec expert at the University of Toronto. And once a PQ government starts taking such actions as a "solemn declaration" on sovereignty, they're bound "to create a very bad reaction from the rest of Canada," worries Gilles Dufour, president of the Conseil du Patronat, which represents Quebec's big employers.

The prospect of such an ugly showdown terrifies Quebec corporate leaders, who are almost universally opposed to sovereignty. Bombardier CEO Laurent Beaudoin warns that sovereignty would "bring high risks of numerous setbacks and of confrontation between Quebec and its partners."

Parizeau downplays such warnings. But even Pierre-Paul Proulx, an economics professor at the University of Montreal who advocates sovereignty, admits that "for the first five years [of independence], growth would be slower" because of a sharp dip in investment. After that, Proulx believes Quebec would do better on its own.

HUGE DEBT. But most other economists are more pessimistic, arguing the breakup would be more difficult than the PQ admits. The price of winning admission to NAFTA, for example, might include raising the subsidized electricity rates that Hydro-Québec provides to aluminum producers. On the financial front, the Royal Bank of Canada, the country's largest, has warned there "is no realistic possibility of two truly sovereign states sharing the same currency."

Even worse, after assuming its share of Canada's debt, Quebec would have a debt load equal to 150% of its GDP, according to the Vancouver-based Fraser Institute think tank. That would help swell Quebec's budget deficit from last year's \$3.7 billion to well over \$10 billion, some economists predict, ultimately producing a liquidity crisis.

Even if separatism carries some negative economic impact, the PQ thinks it can overcome those worries and prevail. "If you had told the founders of the U.S. they would have economic problems if they separated from Britain, what would the answer have been?" asks Bernard Landry, the PQ's vice-president. That kind of sentiment could push Quebec to go it alone.

By William C. Symonds in Montreal

WHAT AN INDEPENDENT QUEBEC WOULD LOOK LIKE

ECONOMY With a GDP of \$117 billion, Quebec's economy is about the size of Denmark's. This year, it expected to grow about 3%; unemployment stands at 11.5%.

POPULATION 7 million.

TRADE To preserve its crucial trade ties with the U.S. and Canada, Quebec would immediately apply for admission to the North American Free Trade Agreement (NAFTA) and seek a new economic treaty with the rest of Canada.

CURRENCY It would continue to use the Canadian dollar.

INTERNATIONAL RELATIONS Quebec would join the United Nations and NATO and maintain its own armed forces. It would also issue its own passports, though citizens would be allowed to continue holding Canadian passports.

DEBT After assuming about one-fourth of Canada's \$438 billion debt, Quebec would have a total debt equal to about 150% of its GDP, making it more indebted than any other Western democracy.

DATA: PARTI QUEBECOIS, THE FRASER INSTITUTE

trepreneurial pollster, "is to stay in Canada, with more powers for Quebec." But with no prospect of a constitutional settlement, that may be unobtainable.

Parizeau believes he can break this deadlock—and win the referendum—by convincing Quebecers that they have been rejected by English Canada. The PQ's strategy will thus be to pursue "measures that will stir up opposition to Quebec in English Canada," predicts

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EUROPE: UNIFICATION FOR THE FAVORED FEW

A Darwinian selection process, separating economically fit countries from the laggards, is under way in the 12-nation European Union. Europe's money markets are prompting the sorting out by punishing governments that don't have their houses in order. The markets, for example, have now widened the interest-rate spread between the 10-year bonds of Germany, with its sturdy mark, and Italy, with its shaky lira, to a huge 465 basis points.

Those brutal pressures are forcing the Germans and French to publicly back a strong inner core of EU countries able and willing to form a tight monetary union. That means a multitiered Europe is almost certain to emerge (chart). The inner core, led by Germany and France, will include Holland, Belgium, and Luxembourg in a hard-money nucleus with the Bundesbank calling the monetary tune. Other EU members will be more loosely linked to the core group in what French Prime Minister Edouard Balladur describes as "concentric circles." That vision is also advocated by the Christian Democratic Union, the senior party in Germany's ruling coalition.

TORN DREAM. All this comes as a blunt acknowledgment that the EU's lockstep march to a broad monetary and political union of 12 nations has failed. The countries left out of the inner core aren't happy about it. Italian Prime Minister Silvio Berlusconi denounced the concept as "disruptive," and British Prime Minister John Major, in a Sept. 7 speech, flatly rejected any notion of a multitiered EU. But there doesn't seem to be any going back: The Germans and French see the core group as a source of cohesion that would give the EU more decisiveness on issues from the Balkan conflict to relations with the U.S.

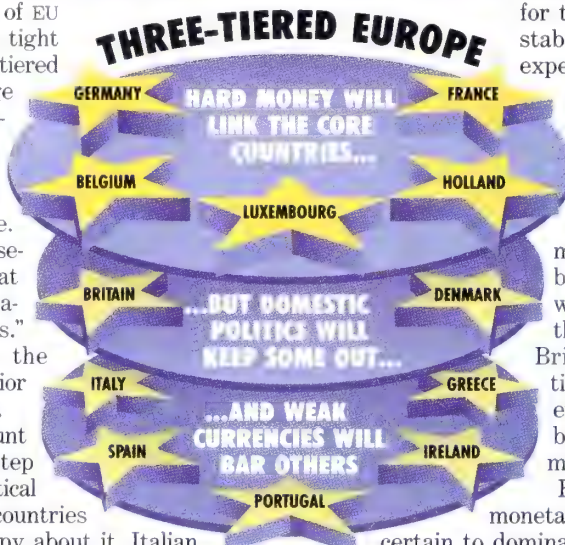
What's reviving the prospect of this monetary club is Europe's recovery, which should cushion the pain of tying together the five nations' economies more tightly. A step toward their monetary union is a Sept. 10 meeting of EU finance ministers in Lindau, Germany. In accordance with the 1992 Maastricht Treaty, the ministers will identify countries that are on track to meet criteria to form a monetary union. The targets include a public debt of not more than 60% of gross domestic product and inflation rates within 1.5% of the average

for the three EU members with the most stable prices. Core group members are expected to meet these goals by 1996.

STERN JUDGE. Italy doesn't stand a chance of meeting those targets. And the EU finance ministers may even penalize Europe's fiscally unready by such steps as cutting off access to loans from the European Investment Bank. That will widen the gap between A-team countries and beneficiaries: Markets will react by raising the laggards' borrowing costs. Although Britain and Denmark could probably tighten their fiscal and monetary reins enough to qualify for inner-club membership, domestic political opposition may keep them out.

Even for France, turning over its monetary sovereignty to Germany—which is certain to dominate the small EU nucleus—looks like a nearly insurmountable hurdle. But markets have been imposing their own judgments on Europe's political agenda, leaving the EU little choice. With new candidates for membership lining up and a constitutional convention in 1996, this multistep plan for unity offers badly needed direction. Not to mention incentives for tougher economic discipline.

By Bill Javetski in Paris with Patrick Oster in Brussels



GLOBAL WRAPUP

UNIONS TEST NAFTA

Unions in the U.S. are using the North American Free Trade Agreement's side accord on labor to help Mexican workers bargain with American owners of Mexican plants. On Sept. 12 the National Administrative Office (NAO), set up in Washington under the Labor Dept. to implement the pact, will hear charges by the Teamsters against Honeywell Inc. and by the United Electrical, Radio & Machine Workers of America (UE) against General Electric Co.

The Teamsters say Honeywell fired workers at its Chihuahua plant for trying to organize a union affiliated with

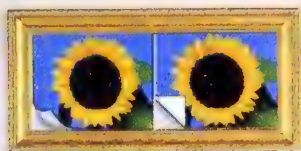
Mexico's independent Authentic Workers Front. The UE charges that GE defeated the Mexican union's bid to represent GE workers in an Aug. 24 election at its small-motor factory in Ciudad Juárez by offering wage hikes and threatening to close the factory. Such tactics "are illegal there and would be here," the Pittsburgh-based UE says. GE denies these charges.

U.S. human-rights groups have also filed complaints against Sony Corp. for alleged union-blocking actions at its plants in Nuevo Laredo. Although the NAO has no enforcement powers on such issues, the unions aim to use NAO hearings and investigations to prod companies to make concessions.

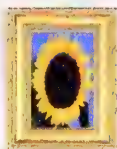
FRENCH EXECUTIVES IN TROUBLE

France's rash of business corruption probes has touched another pillar of the corporate Establishment: Chairman Jean-Louis Beffa of glassmaker Saint-Gobain. An investigating judge suspects him of paying \$830,000 in bribes to officials of a French town in exchange for a water-service contract.

The case is a particular black eye for French business because Saint-Gobain has long been admired as a model of good management. In addition to Beffa, the chairmen of Alcatel Alsthom, Schneider, and Yves Saint Laurent are under investigation for alleged financial improprieties.



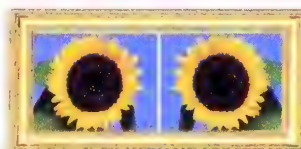
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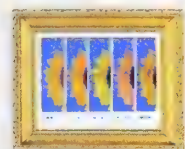
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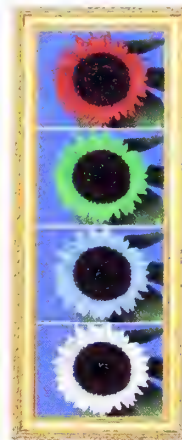
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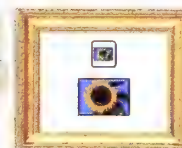
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FOR COLGATE-PALMOLIVE, IT'S TIME FOR TRENCH WARFARE

Good overseas results can't hide the grim news on home shelves

Ask Reuben Mark a question about Colgate-Palmolive Co.'s U.S. business, and often as not, he'll tell you about the rest of the world. What about Colgate's sluggish reputation for new-product development in the U.S.? Mark will talk about three new products quickly rolled out across Europe. How about Colgate's sinking U.S. profitability? Mark enthuses about soaring margins in Mexico.

That's hardly surprising. As head of the global household-products giant, Mark currently boasts far better performance abroad than at home. But increasing trouble is nevertheless forcing Mark to focus more attention on the home front these days. As sales of toothpaste, detergent, and personal products nose-dived in the second quarter, Colgate's U.S. revenues fell 13%, while operating earnings collapsed, dropping 30%. That followed a sluggish 1993 in North America: Colgate's sales in the hypercompetitive market fell slightly, to \$2.53 billion, while operating earnings grew just 2.4%, to \$332 million. "Colgate's U.S. business is heading south, and they don't have a clear strategy to put it right," says Dean Witter Reynolds Inc. analyst William H. Steele.

The second-quarter plunge sent up red flags over much of Wall Street, fueling recent rumors that another major restructuring—Colgate's fourth in a decade—would soon be announced. Mark denies the rumors and says Colgate's current problems have been much overdone. "There's nothing in the recent numbers that suggest we've met our Waterloo," he says. Still, he is clearly speeding efforts to shore up the troubled U.S. unit. A key problem area is the struggling detergent business, where brands such as Fab and Ajax have fallen to only 5% of the market from 10% in the late 1980s. A shake-up of the U.S.

division has begun under new head Lois D. Juliber. Colgate is also launching a slew of new products, from toothpaste to bar soap, and backing them with a hefty rise in ad spending.

PRUNING JOB. Colgate has certainly come a long way since Mark, now 55, took over as chief executive in 1984 and began pruning the once unwieldy company down to five core businesses: oral care, personal products, household cleaners, detergents, and pet food. Mark has steadily moved Colgate away from household products, with their profit margins of below 10%, and into personal products: The Mennen Co. deodorant brands

purchased in 1992 brought profit margins of 14.2%. With such moves, combined with a diet of cost-cutting and acquisitions, he has achieved constantly rising margins, cash flow, and stock performance. His often met goal of delivering 15% annual growth in earnings per share made him a Wall Street favorite.

Now there's skepticism over whether he can keep it up. Despite a revival of Colgate's European business and booming sales in the developing world, the rapid slide in the U.S.—which accounted for 35% of Colgate's 1993 sales of \$7.1 billion and 38% of operating earnings of \$888 million—is denting overall profit



DID TOUGH COST-CUTTING IN THE U.S. FORCE COLGATE CHIEF REUBEN MARK TO SKIMP ON MARKETING?

ility. Oppenheimer & Co.'s Gabriel D. Lowy expects Colgate's 1994 revenue to rise 5.3%, to \$7.5 billion, while operating profit, excluding nonrecurring items and corporate expense, will grow just 5.4%, to \$937 million—far below the 18% growth it has averaged since 1989.

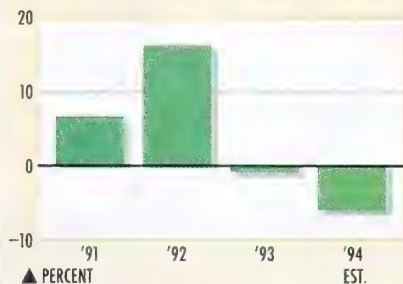
Analysts say Colgate will still meet its ambitious, double-digit profit-growth goal—but only thanks to a massive stock buyback. Because it has bought up 8% of its shares since early 1993, Lowy expects Colgate to turn in earnings per share of \$3.80, up 12.4%. "They're relying on financial engineering to manufacture continued earnings growth," he says. That's a charge Mark vehemently denies. He says Colgate bought its shares because it had too much equity relative to debt after using stock to pay for Mennen. Rather than reporting even higher earnings against its lower number of shares, he says, Colgate pumped extra promotional money into Latin America. "This is a normal part of our plan for maintaining a healthy balance sheet," he says. "We have made our earnings goal in the past, we will meet it this year, and we will make it in the future."

But to do so, Mark will have to cope with a fierce competitive squeeze in the U.S. Lower-cost products such as Dial Corp.'s Purex detergent have bitten into Colgate's share. Meanwhile, market leader Procter & Gamble Co. has turned up the heat, thanks to a restructuring that cut it with far lower costs. "Procter can now drive prices down while still increasing advertising and R&D," says Gary M. Stibel, a marketing expert at New England Consulting Group. "That's making it increasingly difficult for competitors such as Colgate to hang on."

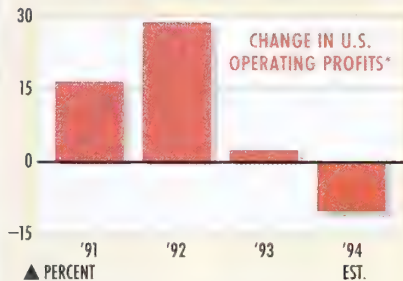
COLAID RESCUE. Colgate has made restructuring efforts of its own, cutting estimated \$25 million from annual North American costs since its last restructuring in 1991. But critics say that too much of that savings came from penny-pinching on product development and marketing. "They haven't invested consistently in their brands," says one former high-ranking Colgate executive. While the cost-cutting was necessary, they haven't had the money to grow the business."

The result: a market-share drubbing in recent years. The erosion has been most severe in toothpaste, Colgate's biggest product in the U.S. Since 1992, Colgate's market share has fallen from 25% to 21.7% in the face of Unilever's successful launch of Mentadent, a combined peroxide and baking soda toothpaste. Colgate's deodorants have likewise lost out to innovation at Gillette Co., which scored with its Series 3000 of clear gel deodorants. While Gillette's share has grown 3.1%, to 19.3%,

COLGATE'S CAVITY PLUNGING U.S. SALES...



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since 1992, Colgate's has fallen to 14.1%, from 15.4%, after it took over Mennen. Mark says Mennen is "performing above our financial expectations," largely because of overseas expansion.

The job of reviving U.S. growth now falls to Juliber, the new head of U.S. operations. She is a 45-year-old marketing whiz who spent the last three years overseeing R&D and manufacturing. In the late 1980s, Juliber doubled sales and tripled profits at Colgate's Asian operations in only three years. Earlier, at Kraft General Foods Inc., she turned around Kool-Aid and other ailing powdered soft drinks. "She's a taskmaster at growing brands," says Clay Tim-

Analysts say Colgate will meet its ambitious profit goals thanks only to a massive stock buyback

on, a former Colgate advertising head who now runs Landor Associates, a San Francisco-based marketing firm.

Juliber is mum on specifics. But a shake-up in sales and marketing is under way, including the naming of a new U.S. sales chief and a new boss at the key oral-care division. Improving advertising will be a top priority. "More money will be spent on better ads," says a source close to Juliber. She's also likely to cut back on proliferating product sizes and variations. "Expect to see much more focus on fewer key brands and key products," says the executive.

Juliber's biggest task may be improving Colgate's lackluster new-product performance in the U.S. Her first test comes immediately: Colgate has begun a major launch of products developed while she oversaw R&D. They include Palmolive antibacterial dishwashing liquid, a reformulated Irish Spring soap, and Platinum, a whitening toothpaste Colgate is marketing to dentists and consumers. Colgate is also extending its Murphy's brand of wood cleaners into a line of kitchen cleaners. The new products will be backed by heavy ad spending, expected to rise 15%.

Analysts say the products should help bring sales back up by yearend, though none is expected to be a blockbuster. For that, Colgate may have to wait for Total, an antibacterial toothpaste that has gained share around the world but is awaiting Food & Drug Administration approval. And further acquisitions are also likely. Colgate is looking at the household-products division of Lehn & Fink Products, the \$1.14 billion business recently put on the market by Eastman Kodak Co. Buying L&F and its key Lysol brand would give Colgate something else to make in its underused factories. If Colgate doesn't win L&F, restructuring of its U.S. plants looks more likely.

The question is: Will Colgate be able to fund its recovery while fighting ever-tougher competition? No one expects Procter to reduce U.S. price pressure. Instead, it's likely to cut more prices in Europe. "Colgate looks to be putting the right strategy in place," says a former executive. "But if growth and earnings remain difficult to come by, their ability to finance acquisitions and invest in products will be increasingly at risk."

Mark rejects such skepticism out of hand, arguing that critics shouldn't focus on the U.S. alone. "You've got to look at Colgate as a whole; one way or another we've always delivered on our financial goals. Three years from now, we'll still be here, and that will still be true." Now, does anyone want to hear about profits in Mexico?

By Jane A. Sasseen in New York, with Zachary Schiller in Cleveland

AND NOW, DESIGNER MOTOR OIL?

Quaker State's Herb Baum thinks he can give lubricants cachet

Like most Americans, Herbert M. Baum did not know how to change the oil in his car. Nor did he know what 10W-30 meant. But since becoming chief executive of Quaker State Corp. last year, the former Campbell Soup Co. executive has tried to turn his ignorance into a strategic advantage for the struggling motor-oil company. How? Baum figures he has a better bead than his rivals on how to sell motor oil to the great mass of oil-ignorant consumers.

To prove his theory, on Sept. 1, Baum launched his first new product, a motor oil for the growing fleet of light trucks, sport-utility vehicles, and minivans, called Quaker State 4x4. Quaker is promoting the oil much as a consumer-products company would sell soup or beer, complete with a \$5 million ad campaign. Baum calls it "the first volley toward making oil consumer-friendly."

SHELF SPACE. Whether he succeeds or not, Baum, 57, seems certain to shake up the sluggish motor-oil business. Retailers traditionally have regarded motor oil as a loss leader, and manufacturers have promoted their brands mainly with costly rebates. Baum hopes to change that: He's pricing the new 4x4 oil at \$1.75 per quart—vs. \$1 for Quaker's standard lines—and promising retailers higher margins. He's hoping to win more shelf space for Quaker's products in return.

Baum believes brand recognition is critical to any consumer product. He spent 15 years fighting brand wars at Campbell, where he rose to become president of North and South American operations. One of his accomplishments: building the Prego spaghetti-sauce brand.



CHANGE AND TUNE-UP: BAUM HAS HIRED A SLEW OF MARKETERS

If he can work similar magic in motor oils, Quaker may be on the road to a sustained recovery. In the late 1980s, under Baum's predecessor, Jack W. Corn, Quaker kept prices high while rivals discounted and rebated. Sales fell and market share plunged (chart). Before long, Quaker ceded market leadership to Pennzoil and soon fell behind rivals Valvoline, Havoline, and Castrol. In 1992, with Corn preparing to retire, Quaker lost \$31.2 million on revenues of \$724 million, excluding one-time accounting changes. The board then appointed Quaker's first outsider CEO in its 63-year history.

Baum arrived at Quaker in June, 1993, and was soon dismayed. "If I'd done the proper due diligence," he now says, "I'd never have taken the job."

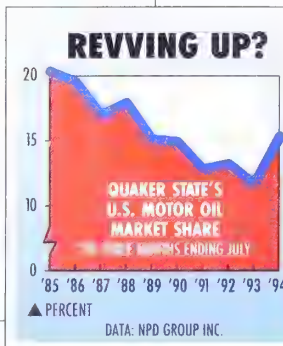
Quaker had done virtually no consumer research. And instead of focusing on its core business, Quaker was heavily involved in unrelated ventures, such as insurance. Even though Quaker climbed back into the black, with 1993 profits of \$13.7 million on sales of \$759.1 million, Baum dubbed the Oil City (Pa.) headquarters "the nightmare on Elm Street."

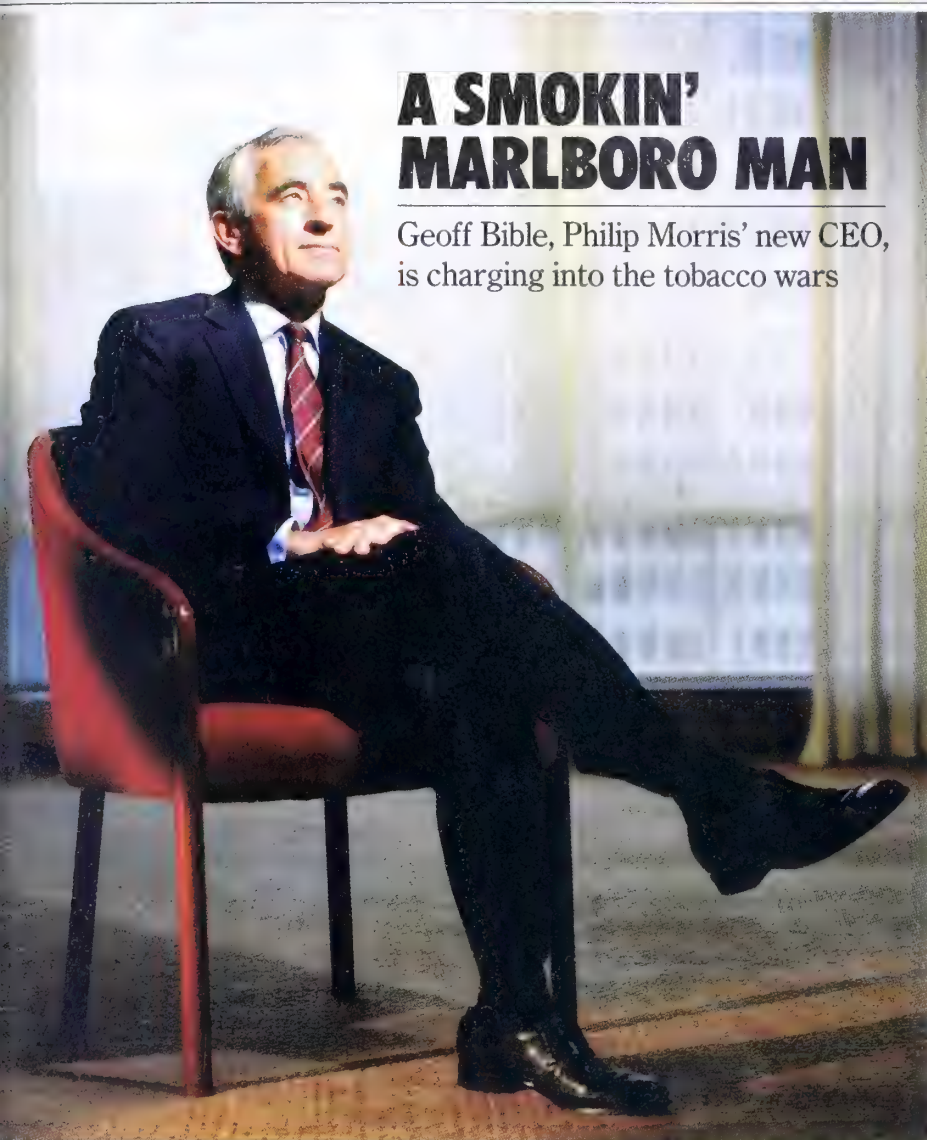
He promptly brought in a cadre of marketers, including former Campbell executive Charles F. Bechtel as vice-president for sales. They set to work to establish brands. But first, they had to convince Quaker's oil hands that consumers were confused by traditional motor-oil labels. They invited engineers to watch focus groups from behind one-way mirrors. One engineer emerged from session stunned that no one in the group could define synthetic oil. "You've got to pick smarter focus groups," he declared. **STEADY GROWTH.** Quaker quickly aimed for the expanding truck market. Its new 4x4 oil is similar to other blends, such as Valvoline's Durablend. But Baum has hired ad agency Chiatt/Day in Los Angeles to turn it into a popular brand, one that even the oil-illiterate would recognize. Quaker's new ads focus solely on its products. And to minimize distractions, Baum dropped actor Bud Reynolds as Quaker's pitchman.

Baum is also refocusing the company squarely on motor oil. After selling Quaker's Heritage Insurance Group to General Electric for \$86 million, he agreed in August to pay \$121 million for Special Oils in Shreveport, La., a motor-oil producer and Quaker's biggest distributor. That will nearly double Quaker's sales, to \$800 million, and make it a big player in the growing oil-recycling business. By 1996, Baum also plans to increase Quaker's Q Lube and other fast-oil-change outlets by a third, to 600.

Baum aims to regain market share, 1% per year. So far, he's ahead of his plan. But much of the growth still comes from rebates. And many competitors doubt consumers are willing to pay premium prices for motor oil, no matter what the brand. The industry has poured \$100 million into promoting pricey full-synthetic oils in recent years, but such brands still account for only 2% of the market. Just four months ago, industry leader Pennzoil considered marketing a new premium brand but decided it wouldn't produce significant sales. Still, if Baum's new brands catch on, he could go down as the guy who changed the motor-oil industry without knowing how to change his oil.

By Stephen Baker in Oil City, Pa.





A SMOKIN' MARLBORO MAN

Geoff Bible, Philip Morris' new CEO, is charging into the tobacco wars

COMBATIVE BIBLE SEEMS TAILOR-MADE TO LEAD THE EMBATTLED BEER AND TOBACCO GIANT

Geoffrey C. Bible is expounding upon some of his fonder habits. "I'm a drinker," he says. "I like beers very much, and I just spent my holiday sampling them all." Smoking? He takes a long drag on his Marlboro. "I smoke more menthol [Marlboros] than I do these," he says. If it seems strange in these health-conscious times for the CEO of a multibillion-dollar corporation to be lavishing so much attention on the virtues of booze and butts, remember that Bible is the new CEO of Philip Morris Cos., the \$61 billion tobacco, food, and beer giant. Who better than the boss to be a walking advertisement for the company's products? Unlike his predecessor, Michael A. Miles, a lanky, stolid Midwesterner who made his career in the domestic food business and gave up smoking years ago,

Bible is short and tough, a gregarious executive who served in the Australian infantry for five years and doesn't have any mixed feelings about selling or smoking cigarettes. For a company that earned \$5.2 billion on \$16.4 billion in tobacco sales last year, you could almost argue that a CEO who puffs his way through a pack a day as Bible does is setting a good example.

He is also part of Philip Morris' master plan: Tired of being pushed around by the government and media, the company's board wanted a chief executive firmly in the tobacco camp. "What Philip Morris lacked was an aggressive response to criticism," says Bruce Gregory, an analyst at Progressive Partners, which owns 530,000 shares of Philip Morris stock. "Bible is a forceful, vocal leader, and that's why he got the nod."

Adds one former Philip Morris executive who is close to the board: "This is a war." Unlike Miles, "Bible is much more likely to put his helmet on and charge."

Bible has wasted no time taking on the company's adversaries. In the past six months, Philip Morris has sued Capital Cities/ABC Inc. for libel, the Environmental Protection Agency over its finding that secondhand cigarette smoke causes cancer, and both the city of San Francisco and the state of Florida over their antismoking laws. In July, the company rolled out a national ad campaign that tried to dispel the EPA's conclusion. "Nobody wants a wimp to run this company," says Gary Black, a tobacco analyst at Sanford C. Bernstein & Co.

EARLY BOOT? What's good for the tobacco side of the business, however, may not be for the rest of the company. Some veterans of Philip Morris' other units—Kraft General Foods Inc. and Miller Brewing Co.—worry that Bible's intense focus on cigarettes may leave them lacking. "Geoff may do a terrific job of setting goals and [clearing] financial hurdles," says one former top Kraft executive. "But he will have to handle the food guys from the same cultural disadvantage that Miles had to handle the tobacco guys."

Already, Philip Morris has shown its willingness to pare down Kraft. Last year it sold the company's Birds Eye frozen vegetables and Breyers ice cream divisions. Now, Bible says he's "look-

ing hard" at the company's \$4 billion food-service division, one of Miles' favorites. "My own sense is that [food service] is probably something where our skills aren't best employed," he says.

Indeed, three months into Bible's tenure, most Philip Morris constituents are watching to see just how far he will go to boost the stock price, which took a pounding in the wake of the company's intensified legal problems. "Over the next several years, as these product-liability suits ripen and the legislative machine continues whirring, there will be a struggle for control of the company," says one institutional investor. "In the meantime, they're trying in a Herculean fashion to lift the stock." Bible says he worries about the lawsuits, but not obsessively. "I feel very good because of our past record on these things," he

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says. "And I feel very confident about our absolutely brilliant legal team of advisers."

A veteran of the international tobacco wars, Bible spent most of the past 34 years building up Philip Morris' overseas cigarette business. Born in Canberra, Australia, he graduated from Waverley College in Australia and worked as an accountant before joining Philip Morris in 1968. Hired as a finance manager in the company's fledgling Lausanne (Switzerland) office, Bible bought local cigarette plants and specialized in fixing problems at the various food and tobacco companies Philip Morris acquired over the years. He did spend a 15-month stint as president of Kraft in the early 1990s. But he earned the favor of former Philip Morris Chairman Hamish Maxwell by building international tobacco into an \$8.5 billion business, which in 1993 supplied \$2.4 billion, or 25%, of the company's total operating earnings.

To hear Bible tell it, he never gunned for the chief executive's chair. "I just thought if I did a good job and could pay the rent, that was fine with me," he says. (Rent should be no problem these days. Bible made more than \$1.3 million in salary and bonus last year.) Since getting the top job, however, he has slipped easily into the CEO's mantle. His top priority has been appeasing shareholders upset that the stock has been languishing far below its 1992 high of 85.

MAKING AMENDS. Initially, investors were dismayed with the board's June decision not to split up Philip Morris' food and tobacco operations. But since then, the share price has jumped 12% to around 61. Part of the reason is that on Aug. 31, the board voted to increase the dividend by almost 20% and authorized a three-year, \$6 billion stock-buyback program. Earnings are expected to increase 12% this year and 8% in 1995 (table).

Still, some shareholders remain irked. So Bible and William Murray, who was elevated from vice chairman to chairman when Miles left, have been beating the pavement to meet with groups of analysts and some large institutional investors. "They feel their investor-relations efforts have been damaged, and they're trying to make amends," says Michael C. Sandler, who had lunch with Bible in July and is a partner at Pacific Financial Research Inc., which owns 4.6 million shares of Philip Morris stock.

PHILIP MORRIS' EMPIRE OF BUTTS, BEER, AND BITES

	SALES	PROFITS (All figures in billions)	
	1993	1994*	1995*
 DOMESTIC TOBACCO	\$7.9	\$8.0	\$7.9
	2.8	3.3	3.5
 INTERNATIONAL TOBACCO	8.5	9.5	10.6
	2.4	2.8	3.3
 NORTH AMERICAN FOOD	20.9	21.3	21.8
	2.4	2.5	2.6
 INTERNATIONAL FOOD	9.4	9.3	9.6
	1.1	1.2	1.2
 MILLER BEER	3.4	3.7	3.7
	0.4	0.4	0.4

*Estimates

DATA: COMPANY REPORTS, SANFORD C. BERNSTEIN & CO.

Image-crafting seems to be a Bible specialty. While former and current employees describe him as temperamental and intense at work, he knows how to turn on the grace with the outside world. "He's very on edge all the time, but he goes out of his way when he's making a public appearance to emphasize his charm," says one former Philip Morris executive. "He has a bit of the fanatic in him, and he inspires fear in the people who work for him."

J. Bruce Harreld, president of Boston Chicken Inc., used to report directly to Bible when both of them were at Kraft. "I loved working for Geoff," says Harreld. "He's not slippery. You always knew what he wanted you to do." Still, says Harreld, "he doesn't suffer fools lightly." Harreld recalls how Bible would make tough demands and counter expressions of disbelief by saying: "I'm going to tell you this in the simplest 'outback' language I can find," and then bluntly reiterate his request. "Geoff is very confident," says Harreld. "At

Bible says he worries about product-liability suits, but not obsessively: "I feel very good because of our past record"

times, maybe to a fault.

Friends say Bible leaves his toughness at the office. At home, he's a devoted father of three who is happily married to his wife Sara. A Catholic, he goes to mass each Sunday. But even Bible admits he can be a formidable boss. "I don't like loose ends," he says. "I like things to be buttoned up..." He acknowledges that he can be exacting, "but not to the point where it becomes an irritant, I don't think." His former priest, the Reverend Walter Smith, a psychologist and member of the Jesuit order, says Bible is driven by a strong work ethic. "I know Geoff is very demanding of himself," says Smith. "And I know he expects results from the people who report to him."

TREACHEROUS WATERS. As Philip Morris braces itself for battle with court claimants and regulators, some say Bible's biggest challenge will be keeping his friends close and his enemies closer. "The most important

thing for Geoff is to get people around him that he can really trust," says Boston Chicken's Harreld. "Everything will not go well, I guarantee you." Mike Miles, at least, bears no grudge. Miles, who in June said he plans to hold on to his Philip Morris stock, insists he trusts Bible to navigate through what are likely to remain treacherous waters. Bible and Murray "are two very good guys who are very bright and will do an excellent job managing the company," Miles says.

Bible doesn't have to worry about going into battle against Miles in the tobacco wars. The former CEO says "there's zero probability" he would end up running another tobacco company. "I doubt there's any other tobacco company that could see me working for them after all that 'Mike Miles, former smoke stuff,' he says.

Bible, on the other hand, would probably rather die before becoming a former smoker. He recently read Christopher Buckley's novel, *Thank You For Smoking*, a satiric account of the life of a tobacco-company lobbyist. "I thought it was very humorous, very witty," says Bible. Did any of it ring true? "That's a good question," he says. "I just thought it was a pity that our industry was as sailed as such." With that, Bible laughed merrily.

By Laura Zinn in New York, with Gregory Burns in Chicago



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Kids, Weather, Football, And Business.

He might not look it, but Brent Wisch has been around. As Director of International Sales for Pratt & Whitney's Waterjet Systems, it's not unusual for Brent to be working in Singapore one week and Scotland the next. But when this seasoned world traveler learned that his company wanted to relocate him to Alabama, he thought, "This may be going a bit too far." He would later reconsider.

"I recall being amazed by the mountains. I had no idea that Alabama had such an incredible panorama. And that was only the beginning of the good impression Huntsville, Alabama made on me."

Brent will, however, admit to some initial cultural adjustment. "It's true what they say about the slower pace. No business meeting ever starts without a discussion of the weather, or football, or your kids. But it's certainly not a waste of time, because in the process of doing business, it gives you an opportunity to really get to know people."

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ALL THOSE LONG-DISTANCE DISCOUNTS ARE SWEET, BUT . . .

Hikes in basic rates are offsetting special deals and sending phone company revenues ever higher



INTERSTATE RATES, ALTHOUGH SHARPLY LOWER SINCE THE AT&T BREAKUP IN 1984, HAVE BEEN RISING OVER THE PAST FOUR YEARS

If you own a telephone, you probably get a lot of pitches beseeching you to switch from one deeply discounted long-distance service to another. With the intense competition among MCI's Friends & Family, AT&T's True USA Savings, and Sprint's The Most, long-distance telephone customers must be getting some great deals, right?

Not necessarily. Data compiled by the Bureau of Labor Statistics show that basic interstate long-distance rates, though down precipitously since the breakup of the Bell System in 1984, have been rising for the past four years—by nearly 10% from January, 1990, to July, 1994. The hikes offset the discount plans and, along with rising calling volume, helped the long-distance industry post a healthy 8%-plus revenue gain in the second quarter. That compares with a year-over-year gain of slightly less than 5% in 1993's second quarter. As a recent study by market researcher Yankee Group Inc. notes, carriers "seem to be funding the marketing wars lately by slowly increasing basic . . . rates."

The proof is in the Federal Communi-

cations Commission filings. In the past year, AT&T, which carries about 60% of the nation's long-distance traffic, has raised the per-minute charge for basic calls three times—by 4% in August, 1993, 6.3% on Jan. 1, and 4% on June 1. And the increases keep coming: On Aug. 29, AT&T filed a request with the FCC to raise domestic calling-card rates by an average 2.1% and international services by 1%. A month earlier, it had requested rate hikes on 800 lines and international calling-card calls.

LOCKSTEP. So what, you say—I'll just switch to MCI or Sprint. It won't save you much. MCI Communications Corp. and Sprint Corp. have raised their basic rates virtually in lockstep with AT&T. With some 85% of the long-distance market among them, the big three are unlikely to set off a genuine price war.

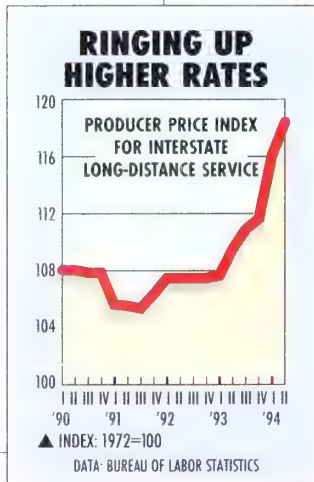
The three dispute the

BLS findings, arguing that extensive use of discounts that range from 10% to 35% makes the basic rate irrelevant—like a car's sticker price. "Nobody, absolute nobody, pays sticker price," asserts MCI President Gerald H. Taylor.

That's not exactly accurate. While none of the long-distance carriers reveals how many subscribers are on discount plans, Yankee Group estimates that some 11 million are enrolled in MCI's

Friends & Family, 6.5 million in AT&T's True USA Savings program, and 5 million in Sprint's The Most. Since there are more than 140 million phone lines in the U.S., it stands to reason that millions of callers, at the least, are paying sticker price.

The carriers also brashly show a set of statistics showing that, overall, rates continue to decline. The true measure of the market, they say, is the



average price per minute paid for long-distance service. That price, which factors in all discount plans, has declined every year for the past decade—by 41.1% in actual dollars and 63.3% when adjusted for inflation, according to AT&T.

But the average price per minute is more than just the money shelled out by consumers. It also includes the deeply discounted rates paid by corporations, which negotiate their own deals with the carriers. Still, even with steep corporate price cuts added in, the decline in the average rate is slowing. The measure fell 2.6% during the second quarter, a 4% drop a year earlier.

Even AT&T doesn't deny that tariff hikes are offsetting the cost of promotions. In its 1993 annual report, AT&T told of a \$750 million rate increase filed last December and a new bargain offering for high-volume callers. "We expect the effects on revenues of this discount plan and those 1994 price increases to offset each other," it said. Certainly the long-distance companies are aware of this balancing act. "The promotions may make it look like there is price competition in residential, but the fact is that the base rates have created profit margins that are much better than you get from businesses," says H. Brian Thompson, chairman of long-distance company LCI International Inc.

PROPAGANDA MILL. One of the reasons profits are better is that costs are lower. The access fees that interstate carriers pay to use local lines, which account for about 40% of their costs, have been falling steadily for years. At one time, those savings were automatically passed on to consumers. But since 1989, when the FCC allowed AT&T more flexibility in setting rates, one no longer necessarily follows the other. The change helped increase operating earnings for the second quarter by 12.4% for AT&T, 20.8% for MCI, and 33.3% for Sprint.

All of this is grist for both sides of the propaganda mill in Washington. As Congress debates an overhaul of telecommunications regulations, the local phone companies argue that they should be given entry to the long-distance market, contending there is no true competition there now. But the long-distance carriers say they are operating in one of the most competitive markets in the world. They do have one unshakable fact on their side: Interstate rates have dropped a lot further in the past 10 years than local tariffs.

So both sides continue to hit members of Congress over the heads with their rate charts. Meanwhile, what's a consumer to do? Well, when they call to enroll in a discount plan, don't hang up.

By Catherine Arnst in New York

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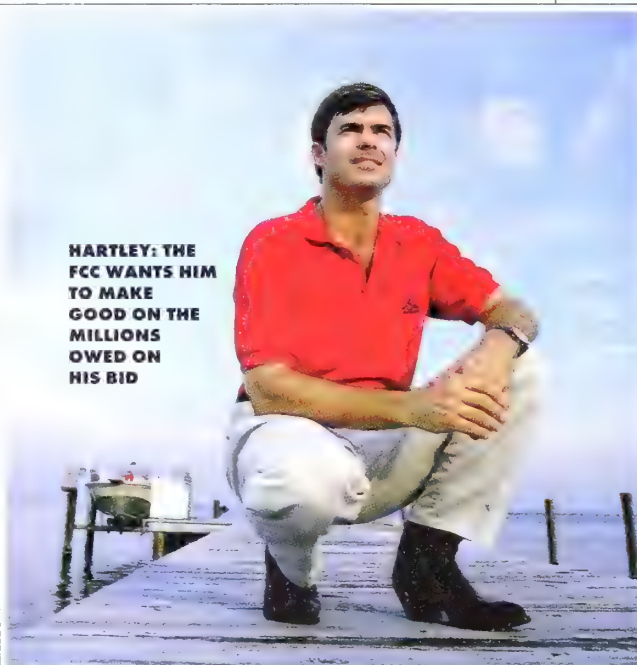
James Hartley thought he wanted a license for interactive TV...

It started with a radio commercial. The 1993 advertisement promoting a new technology, interactive television, piqued the interest of St. Petersburg entrepreneur James C. Hartley. He called the advertiser's toll-free hot line and was sent two videos painting a rosy picture of the fledgling industry. It was, he concluded, a nifty investment for his three children and "for their children."

His kids had better hope he has another idea. After bidding \$42 million to win 20 interactive-TV licenses at the Federal Communications Commission's auction in July, Hartley balked at putting up any money. His explanation: The technology isn't ready, and the FCC can't expect him to pay up until it is. Hartley's decision to default may have prompted a cascade of similar actions, and three federal agencies are now pursuing him as a warning to others. With the FCC preparing for a December auction of air-wave licenses for personal communications services that could fetch \$10 billion, the feds are determined to avoid a repeat performance. "You want to cut off any problems before they occur," says Robert E. Pepper, chief of the FCC's Office of Plans & Policy.

EASY ACCESS. Hartley isn't standing idly by. He has asked the FCC to give him more time to pay and, if the agency refuses, threatens to follow with a federal lawsuit. The agency is unlikely to give in because to do so would invite protests from perhaps dozens of losing bidders, potentially delaying all issuance of any licenses from the \$215 million auction. "This guy, by himself, could slow the industry from getting off the ground," says Benjamin Fink, president of Truman Intertel, a Washington consulting firm.

Hartley wasn't the only neophyte. In



**HARTLEY: THE
FCC WANTS HIM
TO MAKE
GOOD ON THE
MILLIONS
OWED ON
HIS BID**

SPECTRUM DELINQUENTS

The FCC says that 27 of the 178 bidders for interactive-TV licenses failed to make their required downpayments. Here are the top delinquents and what they owe:

Bidder	Number of licenses	Bid	Adjusted bid* Millions
COMMERCIAL REALTY OF ST. PETE	20	\$42.0	\$32.0
INTERACTIVE AMERICA CORP.	15	17.0	13.7
PHOENIX DATA COMMUNICATIONS	5	7.7	5.7
RASPUTIN INTERNATIONAL	5	7.7	6.3
TARIK CHOUDHURY	3	6.2	5.0

*Price after: credit for small businesses, women and minorities is applied

DATA: FCC

an effort to diversify ownership in the telecommunications industry, the FCC made it easy for almost anyone to bid in the TV auction. All that was required was a \$2,500 deposit. One winner's business resumé consisted of selling souvenirs at New York ballparks. Hartley, a 38-year-old scion of a St. Pete real estate family who trained as a civil and industrial engineer at the U.S. Air Force Academy and Florida Technological University, has been a real estate broker

and contractor, has manufactured tennis shoes, and has built personal computers. He concedes that he knew little about the communications business.

Hartley's study of the industry began with the tapes from Chase-McNult Group, the St. Petersburg outfit that was advertising for investors in its interactive-TV license bid. One tape showed developments under way at Eon Corp. of Reston, Va., the only FCC-approved equipment maker for over-the-air interactive TV. By then, however, Eon had shifted to a different approach. Hartley says he asked to see Eon's technology and had several phone conversations with Eon officials. He also had the FCC fax him public notices and press releases on interactive TV. "I spend more time picking my Pop Tarts in the morning than this guy did before bidding \$40 million," sniffs Andrew L. Sernovitz, president of the Interactive Television Assn., a trade group.

BIG WINNER. Hartley pushed ahead. His strategy: snap up a large number of licenses to attain economies of scale. Although he had only \$4 million put up by an undisclosed investor, Hartley says he was authorized by his backer to spend as much as \$40 million. Since Hartley's company, Commercial Realty of St. Pete Inc., was in his wife's name, Hartley counted on the 25% discount for firms owned by minorities and women. When the July 28 auction was over, Hartley's \$42 million bid—reduced to \$32 million after the discount—netted him more licenses than anyone else.

During the week between the auction and the Aug. 7 FCC deadline for a 10% downpayment, Hartley finally visited Eon. He says he was shocked to learn that the equipment wouldn't be ready until mid to late 1995. That, Hartley says, posed a serious problem: Under the FCC rules, construction in each of his markets—which included Miami, Baltimore, and Atlanta—has to be 10% complete within a year.

Hartley proceeded to fax letters to 40 other auction winners, warning them that Eon's equipment would not be ready in time. Eon spokesman Mike Sheward notes that the 12-month countdown will begin only after the licenses are issued.

*By Mark Lewyn in Washington and
nathan Ringel in Atlanta*



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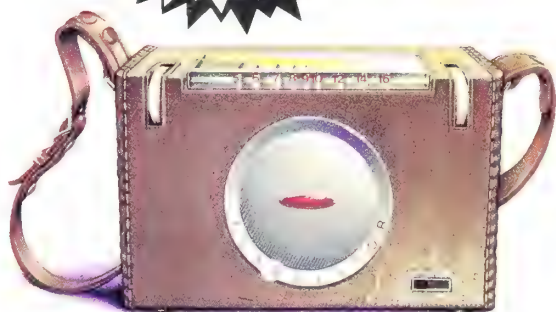


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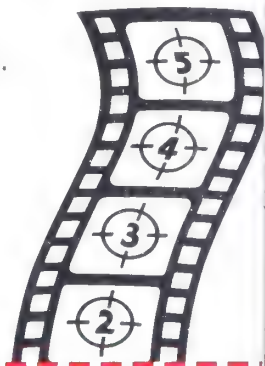
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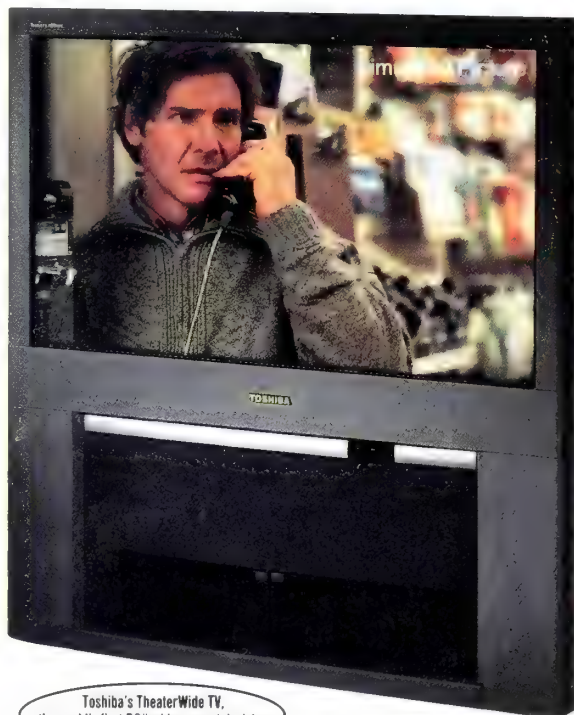
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In Touch with Tomorrow
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IBM KNOWS WHAT TO DO WITH A GOOD IDEA: SELL IT

It's hawking core technology even to rivals—and making a bundle

What's the hot growth business these days at IBM? Superfast workstations for cruising the Infobahn? Complex corporate information systems? Glitzy home PCs with the latest multimedia bells and whistles? Nope. It's the Big Blue technology boutique. No longer determined to keep its core technology to use exclusively in its own systems, the computer giant is selling all sorts of components—disk drives, microprocessor chips, and even the little eraser-like pointer used in its hot-selling ThinkPad notebooks. The boutique also can arrange for IBM factories to make chips for other computer makers. Or its licensing department can collect royalties from companies that wish to use IBM's patented technologies.

Even the fiercest competitor is welcome, and business is brisk. Rivals such as Hitachi, Apple Computer, and Canon shop at IBM for components used in the very products they sell against Big Blue. "We felt IBM was the best," says Ronald K. Bell, chief technology officer for Unisys Corp., which is having IBM build its mainframe chips.

LICENSING COPS. While selling your best technology to outsiders might seem like arming the enemy, IBM has no intention of letting up. Not only does it keep IBM factories humming, but by competing against the world's top component makers, IBM sharpens its game. Best of all, technology sales will add \$3.6 billion in revenue this year, up from just \$600 million in 1992, estimates Salomon Brothers Inc. analyst John Jones Jr. He estimates that second-quarter revenue from such sales—nearly \$1 billion—shot up 400% over a year ago, or 100 times the growth rate for the entire company.

The licensing effort is aimed at protecting IBM's intellectual property and getting better returns from the company's \$5 billion research and development budget. In the past, new technology from the labs was only sold as part of IBM products. Now, Big Blue's marketers

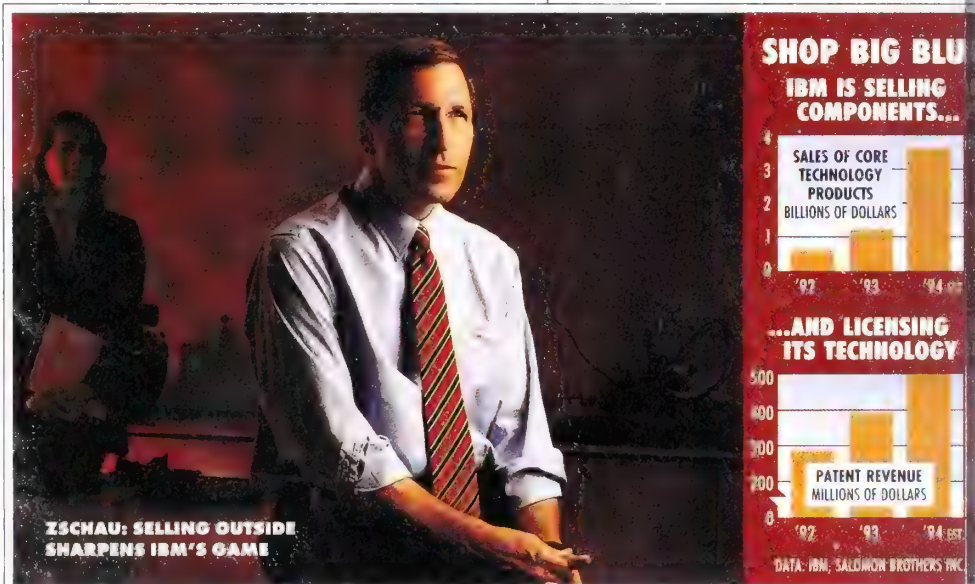
are aggressively pursuing licensing deals. At the same time, IBM lawyers are looking high and low for companies that should be paying IBM royalties but aren't. Together, these efforts will bring in \$500 million this year, up from \$390 million in 1993, IBM says. "If you don't get an adequate return, then you are subsidizing companies with your technology," says Marshall C. Phelps Jr., the IBM attorney in charge of intellectual property and licensing services.

KEY ENDORSEMENT. The returns are healthy, too: IBM collects royalties of 1% to 5% of the retail price of a product using IBM technology. And it all goes to

thermore, Hitachi's endorsement greatly boosts Big Blue's efforts to make PowerPC an industry standard. Says Merrill Lynch & Co. analyst Dan Mandres: "You couldn't have a more visible example of a major technology player committing to IBM technology to prove that they have something."

SLENDER MARGINS. Perhaps the most important reason for IBM's plunge into the component business, however, is what it does for its computer business. If Big Blue can make the latest technology at the right price for customers such as Hitachi, it also will be creating the most competitive technology for its own computers. "That's the reason why this business is so important to us," says Ed Zschau, general manager of IBM's disk-drive business. "As we drive up volume and drive down cost in order to be the leading company in that business, we improve the costs for our other businesses."

Even so, sharpening its skills in marketing technology and components can turn back the clock or restore Big Blue's customary profits. Gross profit margins



the bottom line: Jones estimates license fees could add 40¢ per share in earnings this year.

Big Blue benefits in other ways, too. Take the deal with Hitachi Ltd., signed earlier this year and likely to bring in \$100 million, analysts predict. Hitachi will buy chips—both PowerPC and mainframe microprocessors—to build large-scale computers. The first added benefit for IBM: The company gets access, particularly in Japan, to an estimated 8% share of the world mainframe market that Hitachi controls. It also can use the stream of royalties to help subsidize development costs of future chips. Fur-

thermore, Hitachi's endorsement greatly boosts Big Blue's efforts to make PowerPC an industry standard. Says Merrill Lynch & Co. analyst Dan Mandres: "You couldn't have a more visible example of a major technology player committing to IBM technology to prove that they have something."

Even so, sharpening its skills in marketing technology and components can turn back the clock or restore Big Blue's customary profits. Gross profit margins

in the component businesses hover around 10%—about a third of IBM's overall gross profit margin. "In the total context of things, the increased profit contribution is helping," says IBM Chief Financial Officer Jerome B. York. "But the gross profit margins are very slender compared with other businesses." York, however, can take heart from something else: The more widespread the use of IBM technology, the better the chance of reaping some financial reward even when IBM loses a computer deal to a competitor. Short of winning every deal, you can't beat that.

By Ira Sager in Armonk, N.Y.

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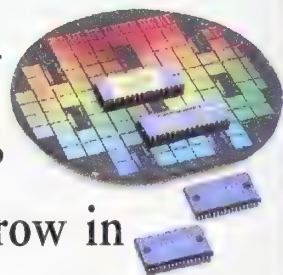
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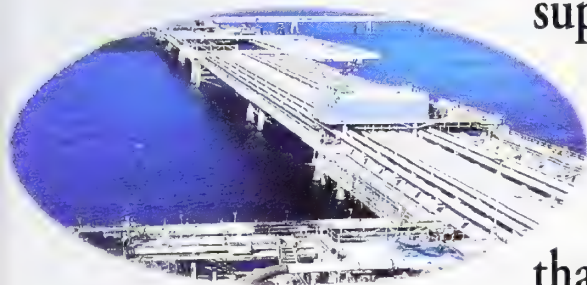
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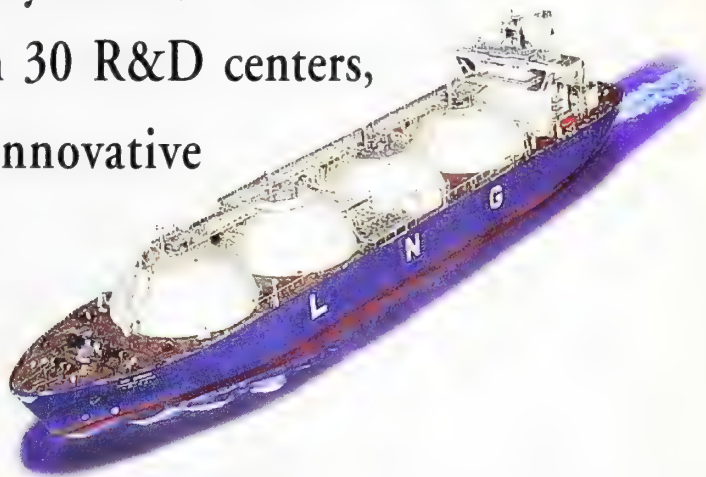
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FANTASTIC JOURNEYS IN VIRTUAL LABS

Computers are picking up where the imagination leaves off

"Every great advance in science has issued from a new audacity of imagination."

Philosopher John Dewey's observation rings as true today as it did a half-century ago. Trouble is, science has gotten so complex since then that only a handful of geniuses can muster the imagination needed to cope with many of its concepts. Take the notion of cosmic strings. This theory proposes that the fundamental building blocks of matter are infinitesimally thin but enormously long threads of energy. In diameter, they're mere billionths the size of an electron. Yet they stretch across vast cosmological distances and into several "higher dimensions" beyond length, width, depth, and time. The vibrations of these strings supposedly tickle zillions of atomic particles—and thus the universe—into being.

If this weirdness boggles your mind, take heart: Even scientists have trouble conjuring something so alien to everyday life. But mathematics can. An equation describing a 10-dimensional space filled with pulsating spaghetti is no less concrete than $2+2=4$. And what math can describe, computers can bring to life on a video screen. That's why "doing science" on computers—call it digital science—is fast becoming as indispensable as imagination.

In fact, digital science marks the most fundamental change in scientific methodology since Isaac Newton laid the foundations 350 years ago. Michael Warren, a physicist at Los Alamos National Lab-

oratory, terms it "the transcendent technology of our time." Yet that accolade barely hints at its profound implications for business and society. Digital sci-

tists have the temerity to envision a time, not far distant, when computers will help reengineer almost anything in Mother Nature's pantry. If you need a drug or a polymer or a metal that has never existed before, tomorrow's supercomputers would calculate whether electrons, protons, and neutrons could be assembled to yield the desired properties—and sketch on a screen how it might be done.

TIME WARPS. Such potential is rapidly putting computers at the cusp of all scientific endeavors. While the machines long ago became vital research tools, they mainly revealed the secrets of nature in mind-numbing printouts of numbers. Digital science is better partly because sight is by far the best human sense for exploring ideas. Being able to interact visually with a simulated experiment helps amplify intuition and creativity, says Robert Langridge, a biologist at the University

of California at San Francisco. As a result, ordinary researchers have a better shot at making extraordinary discoveries.

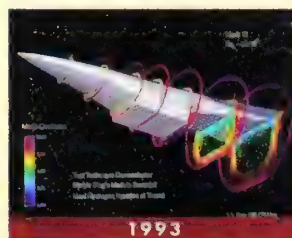
Even more significant, digital science opens vast new horizons to scientific inquiry—many beyond the scope of any real-world laboratory. "A lot of things are possible now that weren't before," says Marvin L. Cohen, a theoretical physicist at the University of California at Berkeley.

Warping time is one example. Astrophysicists can scoop up enough cosmic dust to create a star, watch it wink out of life, burn for billions of years, then flare into a supernova—all in minutes. At the opposite extreme, Scripps Institution of Oceanography researcher Charles Brooks has stretched an eyeblink into a workday. To get a handle on how the mysterious "unfolding" activity of proteins affects their function in the body, he split 1 billionths of a second of action into 750,000 images—enough for a seven-hour video.

There's almost no end to the ne-



IN A FEW YEARS,
SUPERCOMPUTERS HAVE
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WHERE THEY CAN
MODEL AN ENTIRE
HYPERSONIC FUSELAGE
AND THE STRESSES THAT
BUFFET IT AT MACH 10



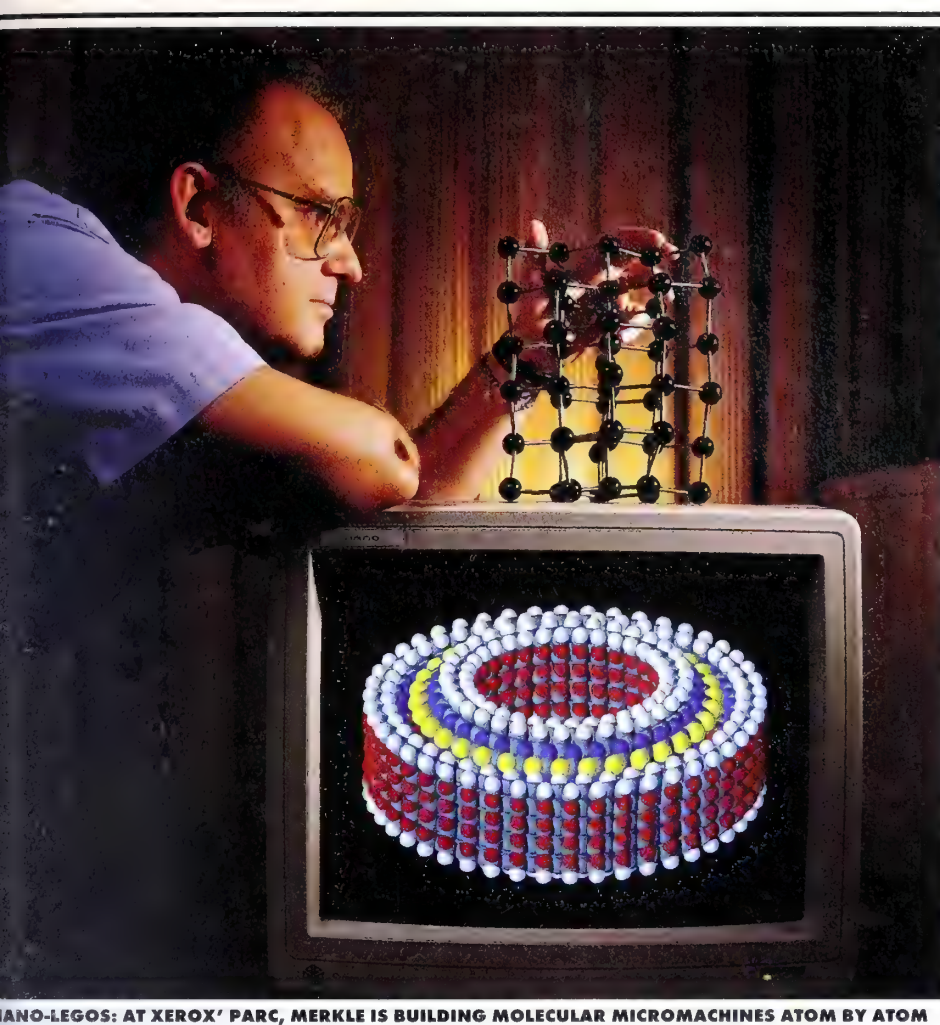
DIGITAL SCIENCE'S GRAND CHALLENGES

Nine Washington agencies are coordinating their digital science efforts to solve 30-odd Grand Challenges—projects that are beyond the capability of any single researcher or lab. Here's a sampling:

COMPUTATIONAL BIOLOGY Understand the components of human and other genomes, and develop software for simulating biological structures. Various projects are being sponsored by the Energy Dept., the National Science Foundation, G.D. Searle, Carnegie Mellon University, and the universities of Tennessee, Houston, and Illinois.

MATHEMATICAL COMBUSTION MODELING Apply computational fluid dynamics to understand the combustion process, which may point to more fuel-efficient car engines. Managed by the Energy Dept.

QUANTUM CHROMODYNAMICS CALCULATIONS Model the physics of



NANO-LEGOS: AT XEROX' PARC, MERKLE IS BUILDING MOLECULAR MICROMACHINES ATOM BY ATOM

types of experiments digital science can do. At New York University, a three-dimensional model of a human heart—beating inside a Cray C90 supercomputer 365 miles away—uses mathematical muscles to pump digital blood. Before NYU medical researchers Charles S. Peskin and David McQueen had access to the Cray at the Pittsburgh Supercomputing Center, the simulation wasn't feasible. Even now, producing each heart-beat takes hours of number-crunching. But with their heart, which won the 1994 Breakthrough Computational Science award from the Smithsonian Institution and *Computerworld* magazine, Peskin and McQueen can probe for cardiovascular cures in ways that would otherwise be impossible.

In the same manner, biochemists at the University of North Carolina at Chapel Hill can tug the molecule of a potential anticancer drug to a so-called receptor site on a protein, then twist and turn it to see if there's a tight "fit," or bonding force, which determines whether the drug can be effective. A scientist actually feels the strength of the bonding force in the mechanical arm used to steer the molecule.

At Australia's Monash University, researchers last summer used similar tools to develop a "designer" molecule that seems to disable flu viruses—permanently. The trouble with flu bugs is that they mutate and quickly develop resistance to drugs. So scientists are forever developing new vaccines. But viruses may not

be able to overcome the Australian antidote because it attaches itself to a mutation-resistant receptor on the virus and prevents it from reproducing. A perpetual flu shot could be a billion-dollar blockbuster for Glaxo Holdings, the drug-maker that sponsored the research. Glaxo launched human trials early this year.

Such near-omnipotent power is fanning a new spirit of adventure in research and engineering: It's encouraging people to tackle projects that used to be too risky or daunting. The upshot, many scientists believe, is that digital science is crucial to any nation that aspires to do world-class research—and to harvest that knowledge for the seeds of tomorrow's high-tech industries. "It's a universal tool that touches every part of science," says Malvin H. Kalos, director of Cornell University's Theory Center.

CAD CATS. Materials scientists on the trail of future microchips at AT&T Bell Laboratories, for example, can now gain fresh insights by doing a takeoff on *Honey, I Shrunk the Kids*: They dive into a silicon crystal to watch electrons whizzing through semiconductor circuits. In pursuit of more efficient engines, Detroit researchers can climb inside and inspect how gasoline gets dispersed into tiny

droplets before igniting. Adolf Coors Co. uses digital models in its search for lighter beer cans. DuPont Co. even simulates disposable diapers, seeking to make them more absorbent. And Caterpillar Inc. saves hundreds of thousands of dollars by using digital prototypes to test designs for earth-moving equipment. Says Donald R. Krull, Cat's head of product research: "Every industry is going to end up doing this."

That's particularly true now that digital science doesn't always require a supercomputer. At Xerox Corp.'s Palo Alto Research Center (PARC), scientist Ralph Merkle runs his experiments on a workstation. He's exploring nanotechnology—building molecular machines by laying atom on atom like a bricklayer

entary particles in atoms and balline lattices. Funded by the Energy Dept. and the National Science Foundation.

NUCLEAR TOKAMAK PROJECT

Develop particle- and fluid-plasma models. Accelerate development of fusion-energy reactors. Headed by the Energy Dept.

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Develop advanced techniques to help discover new materials, using quantum chromodynamics and quantum mechanics. Funded by the Energy Dept. A related project on atomic-level simulations of materials is funded by the National Science Foundation and headed by the California Institute of Technology.

GLOBAL CLIMATE MODELING Expand the theoretical basis for climate dynamics, especially the role of oceans. Sponsored by the Energy Dept. Related programs, focusing on weather forecasting and modeling the dispersion of pollutants, are run by the National Oceanic & Atmospheric Administration and the National Science Foundation.



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putting up a house. Thanks to desktops with the muscle of yesterday's Crays, he says, "we're seeing a democratization and mass spread" of digital science.

Like many technologies, digital science won its first stripes with the Pentagon. After World War II, Washington plowed billions into computers and software to support code-breakers and designers of high-tech weapons. In the process, the feds spawned the supercomputer industry, high-speed data communications, and computer networking. Many software packages now used by industry also have Pentagon ancestry. For instance, auto makers crash-test cars

ton. It culminated in 1985, when the National Science Foundation got \$200 million to create four national supercomputer centers and a nationwide datacommunications system, the NSFnet, to link the centers to three dozen universities. All told, the NSF and its university, state, and 88 industrial collaborators have invested close to \$1 billion in these centers. And the money keeps rolling in. In 1991, President Bush signed the High Performance Computing & Communications Act (HPCC), a five-year initiative that is authorized to spend \$1 billion in fiscal 1994.

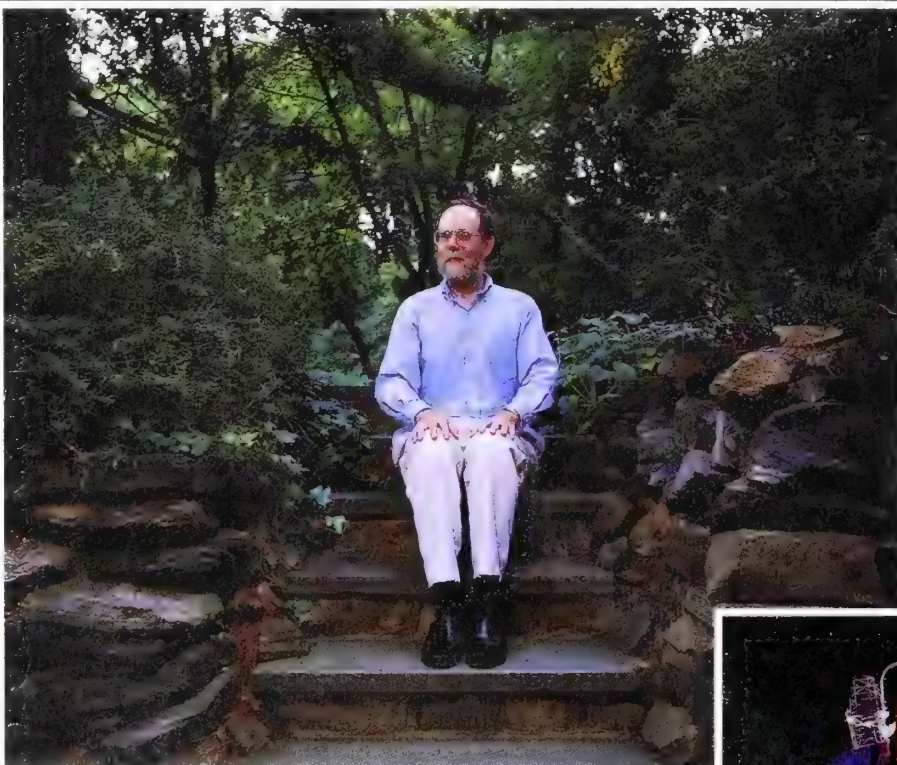
By 1996, the curtain will rise on the

ers. MPP systems have dozens to thousands of microprocessor chips that each pack the raw speed of an older Cray. "We need MPP speeds because we wait to model an oil spill in real time, not get the results after several days and then go check to see if the model was right," says Frank L. Gilfeather, a professor of mathematics at the University of New Mexico and a co-designer of the new Maui High Performance Computing Center (page 84). "We want to predict what's going to happen—in time go out and take preventive action."

At expected prices of up to \$50 million, not many teraops machines will be installed before the turn of the century. But scientists attacking priority problems will have no trouble gaining access to one—wherever it may be. The NSFnet has evolved into the backbone of the Internet, and it now has links to 1,000 colleges plus an increasing number of fee-paying corporate sites.

Keeping the data humming to and from teraops computers will require the fast lanes of the Information Superhighway. These will be gigabit links, capable of pumping data by the billions of bits per second. Most of today's data pipelines top out at only 45 million bits per second, but MCI Communications Corp. is already installing a 2.5-gigabit network. That's enough to transmit all the text in the *Encyclopaedia Britannica* in one second.

GIGABIT PLAYERS. Such speeds should also boost on-line collaborations, with scientists ganging up on complex problems in virtual laboratories that exist nowhere yet anywhere. Before the NSFnet was turned on in 1986, it was unusual for multidisciplinary teams to include researchers from more than one institution. Today, it's common—which means that research projects are tapping



TICKER TECH: NYU'S PESKIN DEVELOPED A THREE-DIMENSIONAL HEART MODEL WHOSE EVERY BEAT TAKES HOURS OF NUMBER-CRUNCHING

in computer simulations using a program based on Dyna-3D, which was written to ensure that an Air Force bomber's nuclear eggs wouldn't crack open if the plane crashed.

Until the late 1980s, most scientists outside the defense establishment could only look on with envy. Martin Karplus, a Harvard University theoretical chemist, recalls having to cadge time at night on a hospital's computer. And Larry L. Smarr, an astrophysicist at the University of Illinois, had to hop to Germany and borrow time on a Cray at the Max Planck Institut.

Smarr soon got fed up and joined mathematician Kenneth G. Wilson, a 1982 Nobel laureate then at Cornell, to lead a lobbying campaign in Washing-

ton. The next act—a new type of supercomputer dubbed "teraops." At peak speed, these machines will chew through at least a trillion operations per second, or teraops—10 to 50 times as many as today's best number-crunchers. Such fantastic speeds are essential for tackling so-called Grand Challenge problems. These are the knottiest puzzles facing science, such as developing fusion-energy reactors and understanding the global climate (table, page 76).

To bypass an inherent speed limitation in traditional computers, teraops machines will be based on massively parallel processing (MPP), a technology pioneered by Thinking Machines, nCube, Intel Supercomputer Systems, and oth-



the best scientific brains in the world. Gigabit links will bring a major new dimension to on-line science. They'll enable biologists, chemists, and biophysicists in Austin, Boston, and Bonn to watch the progress of a digital experiment in all three places at once.

Gigabit networks also will have enough two-way capacity for remote experimentation. Researchers will thus be able to use the best piece of scientific equipment for the task, no matter where it's located. Ultimately, this could "create a distributed laboratory across this country," says Dr. Judith L. Vaitukaitis, direc-

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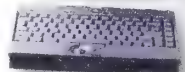
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tor of the National Center for Research Resources at the National Institutes of Health. The outlines of this virtual lab are starting to take shape. The University of California at San Diego's medical school is experimenting with remote access to its high-voltage-transmission electron microscope—one of only six available to U.S. biologists. Now, a neuroscientist at the University of Tennessee can dial up the San Diego instrument to peer at 3-D images of brain cells.

At first, the heavy reliance on computers and mathematical models made many scientists nervous. Computer simulations are, after all, approximations. If a scientist really needed a model

based on fundamental forces such as quantum chromodynamics and quantum mechanics—which, respectively, describe how quarks assemble into protons and neutrons and how electrons behave when orbiting an atom's nucleus—the simulation would be restricted to 10 or so atoms. Any more and even today's biggest supercomputer gags. So scientists devise clever shortcuts, judiciously omitting certain details. "That's where the art is," says Ralph Z. Roskies, co-director of the Pittsburgh Supercomputing Center. For example, digital imitations of the solar system treat the planets as monolithic bodies, not megamasses of atoms. And climatologists studying how

the oceans influence weather patterns may ignore the sunlight reflected by clouds to squeeze in more data on ocean currents.

Juggling this so-called granularity of computer models is a constant headache. Almost always, some degree of accuracy must be sacrificed to get the job done in a reasonable time. Take the National Weather Service's 24-hour forecast. These used to stem from a model that covered the U.S. with boxes 75 kilometers square. Inside these boxes, the weather was assumed to be uniform. Meteorologists knew this model's granularity was too coarse because thunderstorms and tornadoes could come an

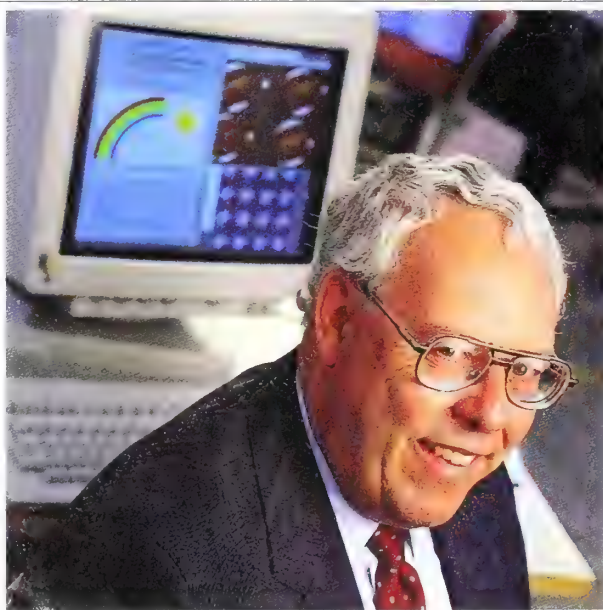
SUPERCOMPUTING FOR THE MASSES

In ancient times, according to Hawaiian mythology, a god scaled Maui's Haleakala volcano to grab the sun and point its rays toward the islands. Today, the 10,000-foot summit is being used as a base for U.S. Air Force telescopes that probe even farther into space. And at the foot of the mountain, near the town of Kihei, is the spanking-new Maui High Performance Computing Center (MHPCC). It's the westernmost point on America's information highway.

Although the Maui center just opened on Aug. 19, by yearend it is expected to be the second most powerful computer facility in the U.S., topped only by the one used by the National Security Agency. When the MHPCC's main machine—IBM's jazziest PowerParallel system—is running on all 400 of its "massively parallel" processors, its peak speed will exceed 125 billion calculations a second.

NEEDY NERDLESS. Some of that power will crunch the data collected by nearby telescopes and support research at Defense Dept. laboratories back on the mainland. But plenty will be left over for industry, says Frank L. Gilfeather, a mathematics professor at the University of New Mexico and a principal architect of the MHPCC. Compared with other Defense Dept. supercomputer facilities, "the Maui center is unique," he says, "because economic development was a principal mission from the start." Since most large companies that need access to a super-

computer are probably affiliated already with a national lab or a National Science Foundation (NSF) supercomputing center, Gilfeather says the MHPCC will stress "working with mid-size companies" that can't afford their own digital-science nerds. "We will



KAHUNA: GILFEATHER FOCUSES ON ECONOMIC DEVELOPMENT

make a special effort to help these companies grow."

The good news for small and midsize companies is that Maui isn't going to be the only game in town. With Pentagon funds drying up, the national laboratories are desperately looking to rope in new sponsors. Los Alamos is even working with Centech Inc., a three-person company in Casper, Wyo., to help develop a better way to recycle oil sludge.

Sandia National Laboratories is also targeting smaller companies with Fast-cast Inc., a consortium formed to improve metal-casting processes with computational tools. Founded in 1989 by Sandia and three companies—Kometek, TrueCast, and Manufacturing Sciences—the group now includes 16 members, some of whom have slashed development cycles from 18 months to 14 weeks.

SAFE TRAVELS. Sometimes these small companies surprise the labs' scientists with new uses for defense technology. For example, Frazer-Nash Consultancy Ltd., a 40-person company in Leatherhead, England, adapted Lawrence Livermore National Lab's Dyna-3D, the software used for crash-testing cars and planes, to analyze what happened to human bodies in the Jan. 8, 1991, train wreck in London's Cannon Street station. Now, Dyna-3D is yielding new insights into how to design safer vehicles of all sorts.

Working with industry may be a letdown for some scientists who for five decades saw themselves as the ultimate defenders of freedom. But Gilfeather believes that the long-term impact of such collaborations could be nearly as sweeping as the fall of communism. Digital science will change so many products and processes for the better, he says, "that it will make a profound difference the world over."

By Otis Port in New York, with Russell Mitchell in San Francisco

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I wonder what's wrong
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☐ ☐

Do you have a frequent need to urinate?

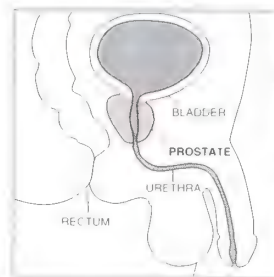
☐ ☐

If you answered yes to even one question, tell your doctor.

Today, symptomatic BPH can be treated by your doctor in several ways. The options are monitoring the condition with regular checkups, surgery, or oral medicines. One oral medicine is

PROSCAR, the only prescription medicine for the treatment of symptomatic BPH that can shrink the prostate.

PROSCAR works by blocking a hormone that can cause the prostate to enlarge. *But it is important to know: PROSCAR doesn't work for everyone. Although the prostate may shrink, there may not be an improvement in urinary symptoms. However, in clinical studies with PROSCAR, some men have seen an improvement in their urinary symptoms after 2 weeks. Others have found that PROSCAR took up to several months to help them.* Because all men are different, you and your doctor will need to determine how PROSCAR is working for you.



The prostate surrounds part of the urethra, the tube that carries urine from the bladder. As the prostate enlarges, it can squeeze the urethra and cause urinary problems.

If you have any urinary symptoms, see your family doctor or a urologist soon, and ask about PROSCAR. For free information to help you discuss your symptoms with your doctor, call 1-800-261-5563.

For the treatment of symptomatic BPH

PROSCAR[®] 5mg
(FINASTERIDE)

The only medicine that can shrink the prostate.

Please see patient information on the next page.

PATIENT INFORMATION ABOUT PROSCAR® (Prah-s-car)

Generic name: finasteride (fin-AS-tur-eyed)

PROSCAR is for the treatment of symptomatic benign prostatic hyperplasia and for use by men only.

Your doctor may prescribe PROSCAR if you have a medical condition called benign prostatic hyperplasia or BPH. This occurs only in men.

Please read this information, as well as the leaflet which accompanies your medication, before you start taking PROSCAR. Also, read the leaflet each time you renew your prescription, just in case anything has changed. Remember, this leaflet does not take the place of careful discussions with your doctor. You and your doctor should discuss PROSCAR when you start taking your medication and at regular checkups.

What is BPH?

BPH is an enlargement of the prostate gland. After age 50, most men develop enlarged prostates. The prostate is located below the bladder. As the prostate enlarges, it may slowly restrict the flow of urine. This can lead to symptoms such as:

- a weak or interrupted urinary stream
- a feeling that you cannot empty your bladder completely
- a feeling of delay or hesitation when you start to urinate
- a need to urinate often, especially at night
- a feeling that you must urinate right away.

Treatment options for BPH

There are three main treatment options for BPH:

- **Program of monitoring or "Watchful Waiting."** If a man has an enlarged prostate gland and no symptoms or if his symptoms do not bother him, he and his doctor may decide on a program of monitoring which would include regular checkups, instead of medication or surgery.
- **Medication.** Your doctor may prescribe PROSCAR for BPH. See "What PROSCAR does" below.
- **Surgery.** Some patients may need surgery. Your doctor can describe several different surgical procedures for BPH. Which procedure is best depends on your symptoms and medical condition.

What PROSCAR does

PROSCAR lowers levels of a key hormone called DHT (dihydrotestosterone), which is a major cause of prostate growth. Lowering DHT leads to shrinkage of the enlarged prostate gland in most men. This can lead to gradual improvement in urine flow and symptoms over the next several months. However, since each case of BPH is different, you should know that:

- Even though the prostate shrinks, you may NOT see an improvement in urine flow or symptoms.
- You may need to take PROSCAR for six (6) months or more to see whether it helps you.
- Even though you take PROSCAR and it may help you, it is not known whether PROSCAR reduces the need for surgery.

What you need to know while taking PROSCAR

- **You must see your doctor regularly.** While taking PROSCAR, you must have regular checkups. Follow your doctor's advice about when to have these checkups.
- **About side effects.** Like all prescription drugs, PROSCAR may cause side effects. Side effects due to PROSCAR may include impotence (or inability to have an erection) and less desire for sex. Each of these side effects occurred in less than 4% of patients in clinical studies. In some cases side effects went away while the patient continued to take PROSCAR. Some men taking PROSCAR may have a decrease in the amount of semen released dur-

ing sex. This decrease does not appear to interfere with normal sexual function. Rarely, some men have reported breast swelling and/or tenderness or allergic reactions such as lip swelling and rash.

You should discuss side effects with your doctor before taking PROSCAR® (Finasteride) and anytime you think you are having a side effect.

- **Checking for prostate cancer.** Your doctor has prescribed PROSCAR for symptomatic BPH and not for cancer—but a man can have BPH and prostate cancer at the same time. Doctors usually recommend that men be checked for prostate cancer once a year when they turn 50 (or 40 if a family member has had prostate cancer). These checks should continue while you take PROSCAR. PROSCAR is not a treatment for prostate cancer.

- **About prostate specific antigen (PSA).** Your doctor may have done a blood test called PSA. PROSCAR can alter PSA values. For more information, talk to your doctor.

- **A warning about PROSCAR and pregnancy.**

PROSCAR is for use by MEN only.

PROSCAR is generally well tolerated in men. However, women who are pregnant, or women who could become pregnant, should avoid the active ingredient in PROSCAR.

If the active ingredient is absorbed by a woman who is pregnant with a male baby, it may cause the male baby to be born with abnormalities of the sex organs. Therefore, any woman who is pregnant or who could become pregnant must not come into direct contact with the active ingredient in PROSCAR.

Two of the ways in which a woman might absorb the active ingredient in PROSCAR are:

Sexual contact. Your semen may contain a small amount of the active ingredient of the drug. If your partner is pregnant, or if you and your partner decide to have a baby, you must stop taking PROSCAR and talk to your doctor. If your partner could become pregnant, proper use of a condom can reduce the risk of exposing her to your semen (discuss this further with your doctor).

Handling broken tablets. Women who are pregnant or who could become pregnant must not handle broken tablets of PROSCAR.

PROSCAR tablets are coated to prevent contact with the active ingredient during normal handling. If this coating is broken, the tablets should not be handled by women who are pregnant or who could become pregnant.

If a woman who is pregnant comes into contact with the active ingredient in PROSCAR, a doctor should be consulted. Remember, these warnings apply only if the woman exposed to PROSCAR is pregnant or could become pregnant.

How to take PROSCAR

Follow your doctor's advice about how to take PROSCAR. You must take it every day. You may take it with or between meals. To avoid forgetting to take PROSCAR, it may be helpful to take it the same time every day.

Do not share PROSCAR with anyone else; it was prescribed only for you.

Keep PROSCAR and all medicines out of the reach of children.

FOR MORE INFORMATION ABOUT PROSCAR® AND BPH, TALK WITH YOUR DOCTOR. IN ADDITION, TALK TO YOUR PHARMACIST OR OTHER HEALTH CARE PROVIDER.



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go in a cell unnoticed. But a finer grid would have taken so long to run that the weather could have arrived by the time the forecast was done. Earlier this year, the Weather Service upgraded from a Cray Y-MP to a faster Cray C90 and reduced the grid to 35-km-square boxes. Still, weather watchers are eagerly awaiting a teraops system.

CLINCHER. Similarly, older Crays at NASA's Ames Research Center didn't have enough muscle to simulate the flow of hypersonic air over a plane's entire fuselage as it moved at several times the speed of sound. So, they had to piece together the results from various sections. With a new Cray C90, however, far more detailed and realistic simulations are possible.

Such successes have gradually persuaded skeptics that digital science is for real. In 1989, Berkeley's Cohen predicted that carbon and nitrogen atoms arranged in a certain crystalline structure would be harder than a diamond. Scientists at Lawrence Berkeley Laboratory, Northwestern University, and Har-

Bad science will persist. Just because a digital experiment works, it doesn't mean the results are valid

vard then produced minute amounts of the new carbon-nitride material—though a process for fabricating commercial quantities has yet to be devised.

Another clincher was an IBM experiment that provided the best proof yet of quantum chromodynamics, or QCD. The equations laying out this esoteric theory are so convoluted that IBM built a custom-designed MPP computer with 500 processors to crunch the QCD math at top speed. The machine ran continuously for a year before the results popped out in early 1993. Physicists were cheered when the answers confirmed most interpretations of experiments with particle accelerators.

Just because a digital experiment works doesn't necessarily mean the results are valid. Computers can be used to model "a lousy experiment or a lousy theory," says Robert J. Silbey, head of the chemistry department at MIT. Until other researchers spot the errors, he concedes, "we may go off in the wrong direction for a while." That's accepted within the culture of science. But it can present major problems when simulations are

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used to formulate public policy. For example, although climate models generally predict global warming, they contradict one another on details that would help decide what to do to counter the greenhouse effect.

HOT TOPICS. Still, the incidence of low models should diminish as digital science permeates classrooms and produces more graduates with good simulation skills. Among the more advanced projects is the University of Washington's molecular biology program, headed by Leroy Hood and backed with \$12 million from William H. Gates III, chairman of Microsoft Corp. Digital science has become "essential and fundamental to biology," says Hood, in tracking down the connections between the estimated 50,000 to 100,000 human genes or determining how billions of neurons in the human brain interact to create thought and perception.

That's true not just in biology. "Complexity" is one of the hot topics in contemporary science, and proponents believe it will turn reductionist science on its ear. Traditional science has groped

One psychology professor foresees "flight simulators for social policy"—sophisticated computer models

for understanding by reducing complex systems to their simplest elements. But this often falls short of a complete explanation, especially when so-called emergent behavior is a factor. Many natural systems made up of simple entities—ant colonies are a good example—exhibit a capacity for self-organization that cannot be explained by the characteristics of the individual members. Complexity theory aims to discover how self-organization comes about.

If the secret is found, says John Holland, a professor of psychology at the University of Michigan, complex simulations could one day serve as "flight simulators for social policy"—helping government leaders navigate the waters of partisan politics to achieve the greatest good for the majority.

That challenge may elude even teraops computers. But the next generation of supercomputers after them—petascale systems, which will spit out calculations by the quadrillions every second—should arrive early next century. Their work will be waiting.

By Russell Mitchell in San Francisco
with Otis Port in New York

A man in a dark suit stands on a thin, dark beam that extends from the bottom center towards the middle of the frame. He is holding up a large, triangular map of a village with red-roofed houses, green trees, and a yellow excavator. The background is a large, swirling globe with blue oceans and green continents, featuring a prominent white cyclone over North America. The overall scene is set against a deep blue sky.

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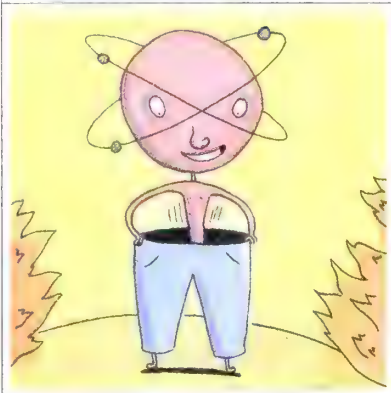
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Developments to Watch

EDITED BY RUTH COXETER

TAKING THE HEAT OFF ELECTRICAL COMPONENTS



As objects grow warmer, they expand, right? Not always, says Oregon State University scientist Arthur W. Sleight. He concocted a composite of zirconium, vanadium, and phosphorus that actually contracts as the mercury rises above room temperature. Sleight attributes this shrinkage to the fact that phosphorus and vanadium atoms bind to an

intermediate oxygen atom, not to each other. Heat makes oxygen vibrate, drawing the other atoms together.

This could have big implications in industries such as semiconductors and optics, where engineers search for thermally stable compounds. The reason: Heat distorts sensitive components, such as printed circuit boards and laser lenses. By mixing grains of the new composite with ordinary epoxies or polymers, Sleight thinks he can counteract heat expansion, leading to components that rigidly retain their size and shape up to 1,500F. Learning how to mix the materials could take another two to three years.

A COMPUTERIZED OVERSEER FOR THE TRUCK DRIVIN' MAN

Driver fatigue, alcohol, and drugs account for two-thirds of all trucking accidents. With funding from the Federal Highway Administration, San Diego-based Evaluation Systems Inc. has developed a computerized driver-monitor system, ReadyShift, to bring those numbers down.

At a set time, the driver pulls off the road and takes a simulated driving test on a monitor that pulls down from the truck visor. The monitor gives orders such as turn left or turn on lights, and it measures the response time. Reactions are transmitted via satellite to a central computer, which compares them to the driver's baseline test. If the driver fails, the computer orders a rest. To enforce this, the computer can prevent the vehicle from starting. Or the truck's location can be plotted via satellite. If it moves, headquarters will know. Although some truckers question whether the test can accurately simulate driving, a freight carrier and a petroleum-transport company in Southern California are trying out the system.

FROM CRUSTACEANS, A PLETHORA OF PAPER PRODUCTS

Sonja I. Salmon spins shellfish waste into paper products. Since North Carolina alone produces about 27 million pounds of shellfish waste annually, the North Carolina State University graduate student has plenty of material to work with. The paper is made from chitosan, a biopolymer similar to the cellulose derived from tree pulp to make most paper. Chitosan has antifungal and healing properties that make it attractive for wound dressings and for air and water filters.

Instead of using the harsh solvents normally needed for papermaking, Salmon uses vinegar to process the waste. Dissolved chitosan is dribbled onto a rotating disk. The acidic solution flies off into a neutralizing bath of sodium hydroxide where it instantly coagulates into short, ribbonlike fibers. These fibers are mixed with water, then filtered and pressed into paper. Salmon's process can be performed with existing paper-mill equipment. These fibers are stronger when wet than cellulose. Salmon says the shellfish paper could purify water, be a matrix for enzymes in fermentation reactions, or even serve as an antifungal insole for shoes.

THE DEEP FREEZE FOR IRREGULAR HEARTBEATS

Cold probe, warm heart. That's the concept behind a super-cold catheter being developed by John Dobak, a San Diego physician who has started a one-man company called Aegis Medical Technologies. The frigid tip of the catheter would kill pieces of heart tissue to stop irregular heartbeats. Such arrhythmia is usually controlled with medication or burning. But drugs aren't always effective and may have side effects. And electrical burning can't always safely treat a big enough area.

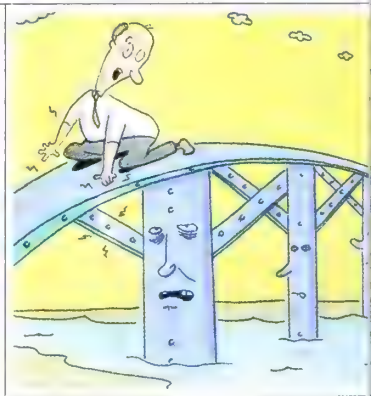
Dobak isn't the first person to think of freezing arrhythmia. One technique is to pipe liquid nitrogen to the spot—a cumbersome method that requires insulating the tube so other tissue doesn't freeze. Another approach is to pass pressurized nitrous oxide gas through a tube, then open a valve inside the tube so the gas rapidly depressurizes and cools. Trouble is, that works down to only about -70C. Dobak is working with cryogenic experts at the National Institute of Standards & Technology in Boulder, Colo., on a variant of the nitrous oxide system that uses a different gas and a different kind of valve. NIST project leader Ray Radebaugh says the system—details of which he won't yet disclose—can achieve a temperature of -50C to -160C. The next hurdle—a big one—is to shrink the catheter down to 3mm or less in diameter.

WHEN A BRIDGE CRACKS, IT'S NOW TRULY SHOCKING

To diagnose the effect of stress on metal objects, University of Pennsylvania scientist Campbell Laird has designed an advance-warning system composed of a simple battery.

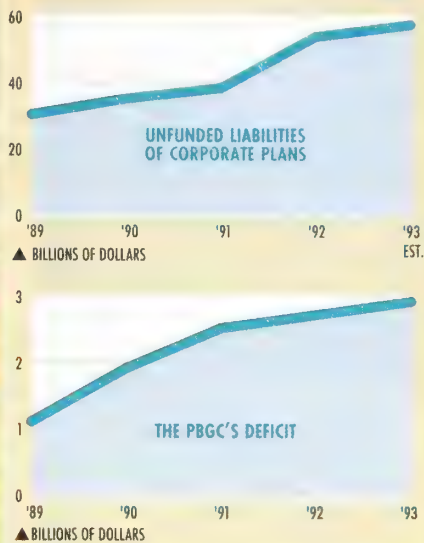
When metal begins to fatigue or corrode, microscopic fissures appear. Those fissures force out metal atoms, producing a current that's just a few millionths of an amp.

Laird measures this tiny charge by using a fluid that conducts electricity. A metal bridge, for instance, acts as the anode and a platinum lead inside the electrolyte solution is the cathode. A computer chip would keep track of current changes. Laird says he can detect cracks just a tenth the diameter of human hair. Los Angeles-based Tensidyne Scientific Corp. has licensed the patented procedure and hopes to have a working prototype in six months.





WHO'LL PAY FOR PENSIONS?



DATA: PENSION BENEFIT GUARANTY CORP., EMPLOYEE BENEFIT RESEARCH INSTITUTE, BW



HAIRSH MEDICINE FOR FAILING PENSION PLANS

Castor oil now, say the Clintonites, may prevent a bailout later

General Motors, Warner-Lambert, Northwest Airlines, and Woolworth are in very different lines of business, yet they share one unsettling problem: They are among the top companies singled out by the federal government for grossly underfunding their employee pension plans. The Clinton Administration has a solution that treats them, and much of the rest of Corporate America, up in arms.

Labor Secretary Robert B. Reich and Treasury Secretary Lloyd M. Bentsen are pushing a pension reform bill that makes insurance premiums paid by some 10,000 underfunded corporate plans to the Pension Benefit Guaranty Corp. (PBGC), the agency that makes sure pensioners receive benefits if their employer goes bankrupt. The measure also would force thousands of companies with healthy plans to boost pension contributions. And it would give the PBGC a bigger say in mergers and asset sales affecting pension plans. "We're not going to stand by while people continue to break promises," vows PBGC Executive Director Martin Slate.

Slate has cause for concern. Unfunded

pension liabilities doubled, to \$53.4 billion, from 1987 to 1992 (chart). If something isn't done now to shore up pension financing and the agency's insurance fund, the agency fears, taxpayers could face a multibillion-dollar financial bailout not unlike the savings and loan debacle. Gary Burtless, a senior fellow at the Brookings Institution, says falling stock and bond prices could mean a huge liability for the government: "Those values can head south very quickly." As Reich warned Congress: "If we wait, the medicine that will be necessary will only be harder to swallow." To business, however, the Reichian remedy tastes like castor oil. Gripses Lisa Sprague, of the U.S. Chamber of Commerce. "Here's one more government agency peering over our shoulder."

CLEVER MOVE? But to the PBGC, someone must pressure companies to keep their commitments. It notes, for example, that last May it had to force GM to pony up \$4 billion in cash for the carmaker's most underfunded plan. That kind of settlement is rare, though—which is why the Clintonites want to impose industry-wide mandates.

In fact, they're trying to tack the PBGC proposal onto separate legislation that enjoys broad business support—congressional approval of the General Agreement on Tariffs & Trade. Since congressional rules for GATT prohibit legislators from amending or even debating changes in the trade bill, it's slated for an up-or-down vote before the end of the year. The Administration also sees another advantage in linking the two measures—the \$800 million in revenues expected from the higher insurance premiums would be used to help offset a drop in budget receipts due to lower tariffs under the trade agreement. Finding sources of revenue to make up for the tariff losses has been a major obstacle to GATT approval.

But the Administration may have been a little too clever by half. For one thing, the legislative gambit has ruffled feathers on Capitol Hill. Members of the Senate Labor & Human Resources Committee are grumbling that they would be deprived of their traditional jurisdiction over the pension measure, since trade bills are handled by the Senate Finance Committee. "It's decent politics," complains one Senate aide. "But it violates the legislative process."

Moreover, GATT passage this year suddenly is looking iffy. Senate Republicans are threatening to delay a vote until next year: Some want to embarrass Clinton, and others fear the proposed World Trade Organization, which would oversee the international accord, might undermine U.S. sovereignty.

Despite questioning its tactics, con-

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TWO INTERNATIONAL FUNDS FROM TWENTIETH CENTURY.

Government

gressional Democrats and Republicans applaud the Administration for addressing a longstanding concern, one that the Bush Administration failed to tackle. At the core of the problem are cushy defined-benefit plans that unions negotiated with such old-line industries as auto, steel, and airlines. These plans guarantee a specified monthly payment after retirement. In contrast, benefits from 401(k) plans and other defined-contribution programs, which the PBGC does not insure, depend on how the pension plan investments fare.

LAST STRAW. The reforms rile Corporate America because they will mandate stricter rules and potentially higher pension contributions for all companies even though only a tiny fraction of businesses are causing most of the problems. Of the 66,000 PBGC-insured pension plans

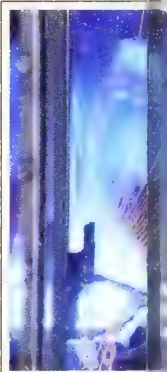
THE GOOD NEWS IS MORE WORKERS HAVE A NEST EGG

Even while some big companies struggle with pensions, there's good news about the overall status of the country's retirement plans. The share of the workforce with any pension plan—which fell at the end of the 1980s—is climbing again, according to a new Census Bureau survey.

The upturn is modest and stems primarily from the spread of 401(k) savings plans, which typically require an employee contribution. Yet, at least more workers now will have something besides Social Security when they call it quits. "Although young and low-wage workers are still losing ground, the overall decline seems to be stopping," says Paul Yakoboski, an economist at the Employee Benefit Research Institute (EBRI) in Washington, D.C.

New data show that 44% of workers now are covered by a pension—either a 401(k) or a traditional one—vs. 43% in 1988 and 42% in 1979. Private-sector workers fare best, with 41% covered vs. 39% in 1988. But public-sector workers, too, remain below their 1979 peak of 45%.

The decline bottomed out because new plans are being set up faster than traditional plans are vanishing. Since 1988, the number of private-sector employees at companies



ferred by 8,000 companies, a quarter are considered underfunded. "We've already layered in this enormous complexity" for all companies with defined-benefit plans, grouses Larry Zimpleman, vice-president at Des Moines-based Principal Financial Group, which says it does not have a funding problem. "This is an added straw on top of the camel's back."

The companies cited by PBGC for problems are also upset. They contend that the agency's method of calculating their pension liabilities vastly exaggerates the problem because the \$53 billion figure assumes two unlikely events: that all underfunded plans are paid off at once and that the PBGC buys every beneficiary an annuity.

And companies complain that the PBGC uses an unrealistically low annual rate of return on pension fund investments. Northwest Airlines Inc., for example, believes it has set aside more

401(k) has jumped 10 percentage points to 37%, according to the EBRI. Many companies, especially small ones, favor them because they need foot only part, or even none, of the bill.

Ask Roger A. Chapman, co-owner of Precision Inc., a Fremont (Calif.) metal company. Chapman could not find a traditional pension plan when he started Rave in 1979. But in 1991, he set up a plan that allows his 48 workers to save 13% of their pay after a year on the job. Rave matches 50% of that, up to 3% of the worker's salary. All but one eligible employee is enrolled. "A 401(k) is really the same in town for us," says Chapman.

More employees are joining up, too. At private companies with 401(k)s, the number of participating workers climbed from 57% to 64% between 1988 and 1993, according to the EBRI. And the average contribution rose from 6.4% of pay to 7%.

John Parsons, a 12-year veteran at Rave, is an example. The 38-year-old welder, never a saver, took advantage of the chance to sock away 10% of his \$25-an-hour wage when the 401(k) was created. "After a while, I didn't even notice it coming out of my check," he says. Critics point out that employees bear the cost of 401(k)s. And two-thirds of those who change jobs spend at least half of their 401(k) distribution, according to EBRI. Still, any pension is better than no retirement with nothing but Social Security to count on.

By Aaron Bernstein in New York



AN: HIS BUSINESS A 401(K)

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M4BWS

Government

than enough money for its pension plan. But the agency says the company's plan is underfunded by \$311 million, based on an assumption that the fund's investments will grow just 6.4% a year. "It's just not true," asserts Northwest Vice President Elliott M. Seiden. He says that the company assumes a 12% to 14% rate of return, based on a 10-year track record.

Still, despite such objections, one troubling trend can't be easily dismissed. From 1987 to 1993, the number of plans that the PBGC has taken over rose 34%, to 1,858. The number of workers or retirees owed money by the agency jumped 62%, to 349,000. And benefit payments the PBGC shelled out annually soared 127%, to \$723 million.

Although the PBGC's income from premiums and investments is more than adequate to make these payments, its balance sheet, which includes actuarial assumptions about future liabilities,

Numbers game: Ford assumes that 17.2 workers per thousand will die by age 65; GM's figure is 32.1

shows a \$2.9 billion deficit, up 87% since 1987.

The Administration claims that businesses with strong pension plans should welcome the reforms because they would force the problem companies to pay higher premiums and plan contributions. Currently, premiums paid by those with sound plans effectively subsidize those who underfund their plans. The legislation also would standardize actuarial assumptions that companies use to calculate their pension contributions. For example, although Ford Motor Co. assumes that only 17.2 male workers per thousand will die by age 65, General Motors Corp. assumes that 32.1 die by the same age—allowing GM to cut contributions.

The PBGC has tried to mollify businesses by limiting many of its toughest requirements to the worst offenders. For instance, the agency wants advance notification about acquisitions and divestitures to apply only to companies that are less than 90% funded. But there are limits on how much the PBGC will back pedal. It wants to make sure that taxpayers don't have to underwrite another huge bailout. A little unpleasant cast oil now might do the trick.

By Christina Del Valle in Washington

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MUTUAL FUND

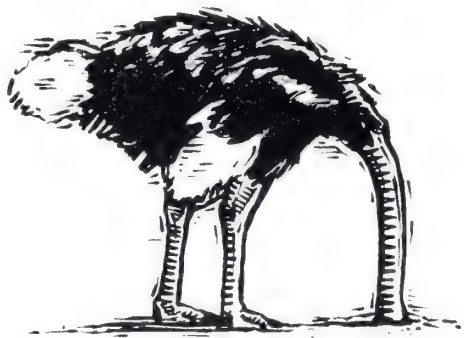
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THE GLOBAL INVESTOR

AS FOREIGN ECONOMIES REVIVE, AMERICANS ARE BUYING UP OVERSEAS STOCKS

When Ernesto Zedillo Ponce de León of the ruling Institutional Revolutionary Party put eight months of political turmoil to rest and captured the Mexican presidency in national elections on Aug. 21, victory celebrations took place not only in Mexico City but 2,200 miles away on Wall Street. All across America, recalls Leo E. Guzman, president of Guzman & Co., a Miami securities dealer specializing in Latin stocks, "brokers were getting a load of orders" for Mexican equities.

The brokers were ready for the buying surge. As their switchboards started lighting up, securities dealers calmly filled orders for millions of shares of Teléfonos de México, Cifra, Ica, Televisa, and other blue-chip Mexican issues that were large-

ly unknown north of the border only a few years ago. That the dealers were able to handle the crush without breaking a sweat was a tribute to the sudden blossoming of the American Depositary Receipt (ADR). The ADR is one of the most far-reaching phenomena to have swept the equity market in decades.

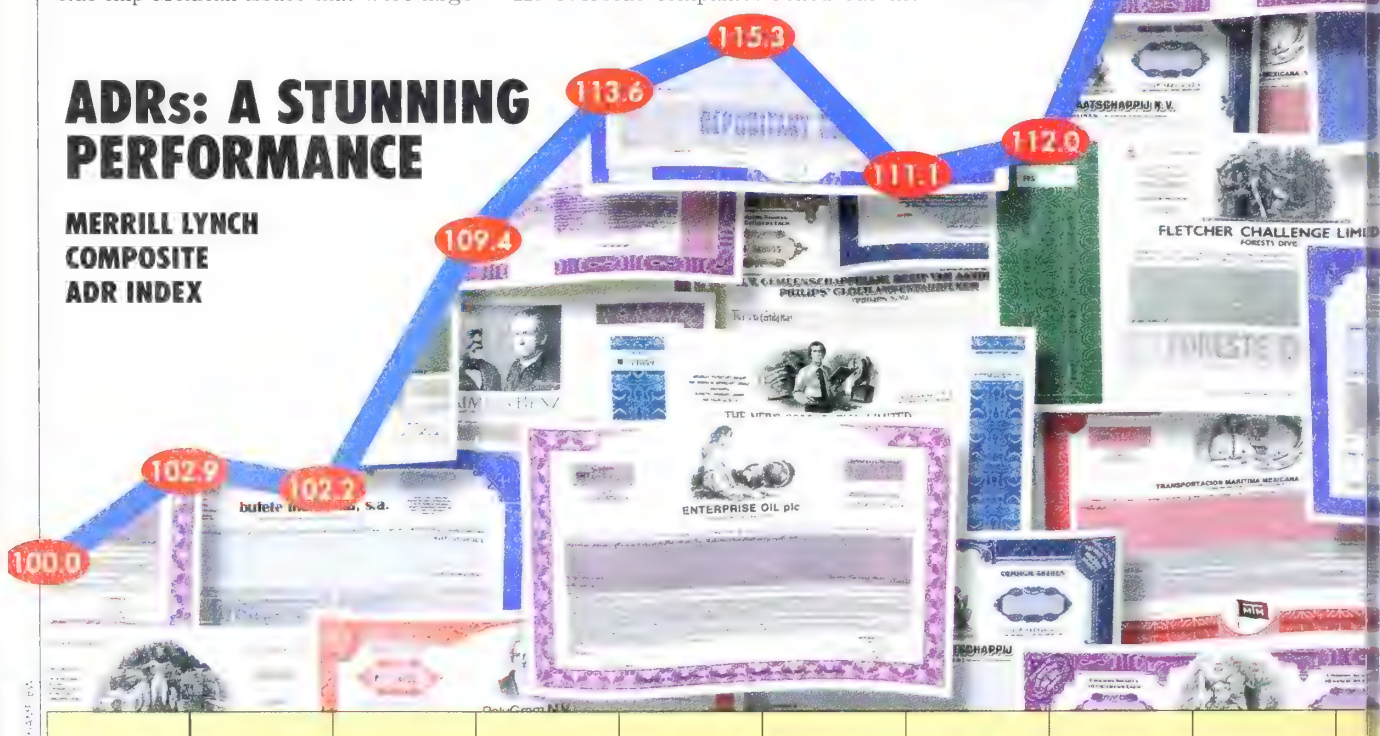
HEAVY HITTERS. With a world economic recovery gathering speed, American investors—from individuals to multibillion-dollar pension and mutual funds—have fallen in love with global stocks. And to meet the growing demand, scores of small and large companies from Australia to Zimbabwe are scrambling to bring their shares to the U.S., the biggest equity market on earth. In fact, more than 110 overseas companies rolled out their

shares in the U.S. in the first half of 1994 alone. Given the turmoil in the U.S. stock market during the period, that was an "absolutely spectacular" development, says James E. Rutherford, a vice-president at the brokerage house of Jans Capel Inc.

Be they conservative European utilities or red-hot Latin American real estate developers, companies from abroad are getting their shares into the U.S. market largely via what used to be one of Wall Street's

ADRs: A STUNNING PERFORMANCE

**MERRILL LYNCH
COMPOSITE
ADR INDEX**



DEC. '92

*INDEX OF PRICES OF 215 AMERICAN DEPOSITARY RECEIPTS TRADED ON THE NEW YORK, AMERICAN NASDAQ, AND OVER-THE-COUNTER MARKETS

most arcane investment vehicles. For all intents, ADRs are overseas shares traded in dollars in the U.S. With the industrial world awakening from recession and emerging markets flourishing, ADRs are becoming the star performers on Wall Street.

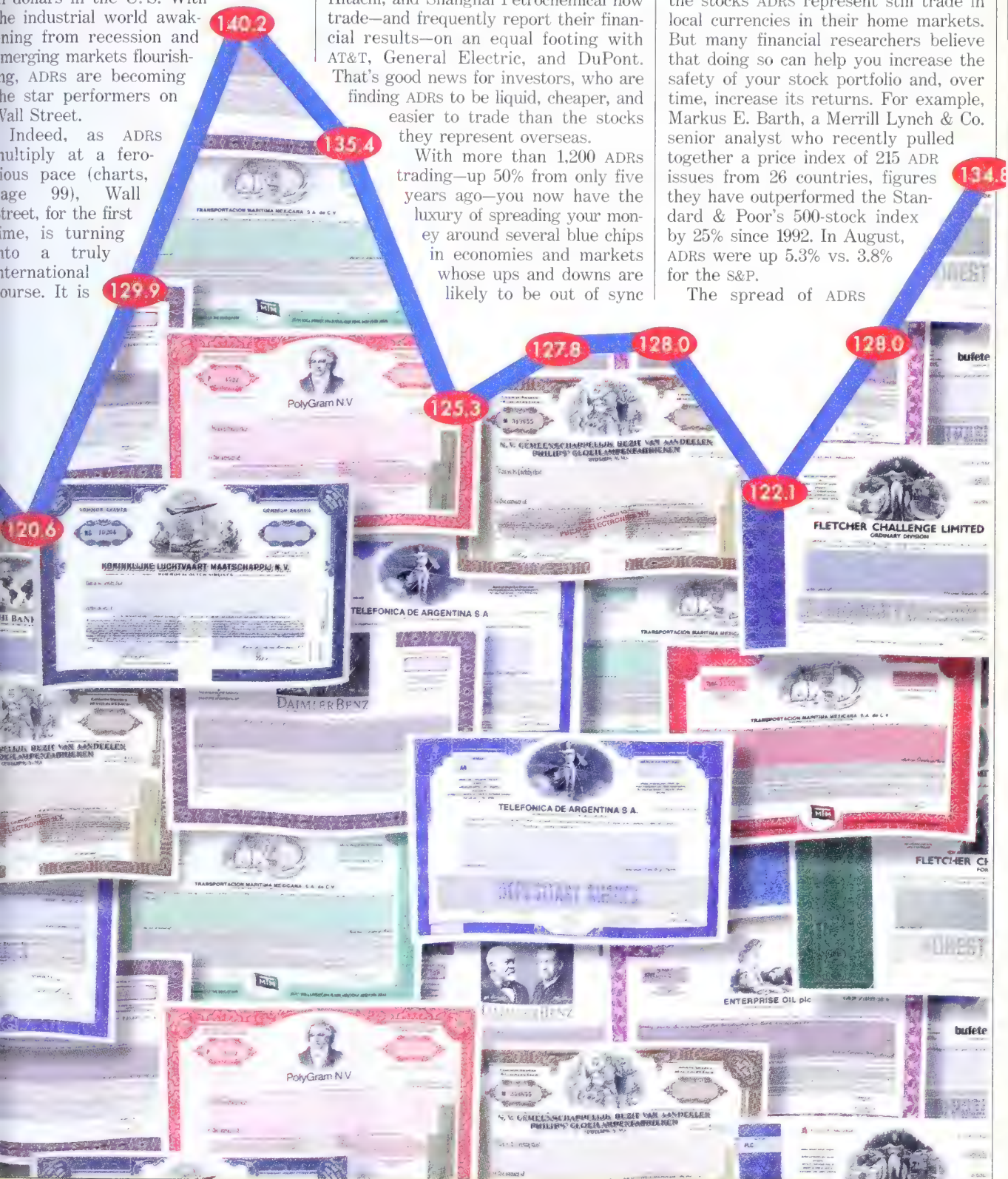
Indeed, as ADRs multiply at a ferocious pace (charts, page 99), Wall Street, for the first time, is turning into a truly international bourse. It is

becoming one where such global heavyweights as British Telecommunications, Hitachi, and Shanghai Petrochemical now trade—and frequently report their financial results—on an equal footing with AT&T, General Electric, and DuPont. That's good news for investors, who are finding ADRs to be liquid, cheaper, and easier to trade than the stocks they represent overseas.

With more than 1,200 ADRs trading—up 50% from only five years ago—you now have the luxury of spreading your money around several blue chips in economies and markets whose ups and downs are likely to be out of sync

with each other and the U.S. You may face foreign-exchange risks in doing so, as the stocks ADRs represent still trade in local currencies in their home markets. But many financial researchers believe that doing so can help you increase the safety of your stock portfolio and, over time, increase its returns. For example, Markus E. Barth, a Merrill Lynch & Co. senior analyst who recently pulled together a price index of 215 ADR issues from 26 countries, figures they have outperformed the Standard & Poor's 500-stock index by 25% since 1992. In August, ADRs were up 5.3% vs. 3.8% for the S&P.

The spread of ADRs



Special Report

gives investors plenty of opportunity to try diversifying this way (table, page 100). According to Morningstar Inc., the Chicago financial research house, stock prices in Japan, whose Nikkei average has rebounded 15% in 1994, have shown a very low correlation with the S&P for five years running. So have Malaysia, Portugal, Spain, and Switzerland, all home to a number of solid ADR issues. Morgan Stanley & Co. analyst Sylvain Massot thinks Swiss foodmaker Nestlé will shrug off the recent surge in world coffee prices and still manage to increase earnings more than 8% this year. Yet Nestlé sells at 14 times earnings—against nearly 17 for Procter & Gamble Co.

LONG RUN. Nestlé is only one of the values awaiting ADR investors. The once-torrid U.S. recovery is slowing to a moderate pace—probably signaling that domestic corporate earnings growth is also due to cool. But many economies overseas are beginning to stage a strong recovery that almost surely will pump up earnings—and could lift stock prices—on bourses abroad.

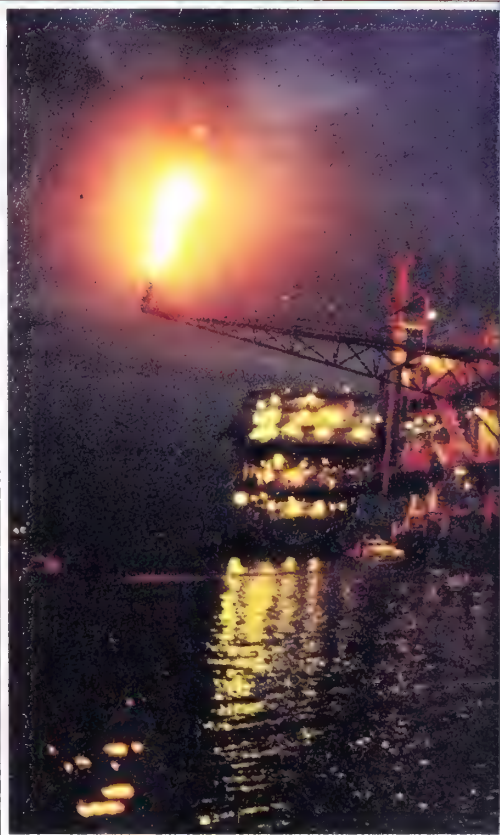
Take Germany. It's likely to achieve 2% growth in its gross domestic product this year and 2.6% in 1995, higher than most analysts thought likely only a few months ago. With manufacturing orders building up, analysts now think German earnings could rocket 60% in 1994 and an additional 40% in 1995. Mexico? With elections behind it, interest rates are expected to fall, giving a welcome boost to bank issues. And China could pump out 10% annual growth this year. That is letting the government go ahead with its

plans to list several new ADRs in the U.S. and is overcoming concerns that Beijing's efforts to rein in inflation would produce an economic rout.

Even Japan seems to be making a comeback from recession. Although the Tokyo stock market may be burdened this fall by the strong yen and the \$28 billion privatization of Japan Tobacco, a \$14,000-a-share issue that will be aimed largely at domestic investors, there still are signs of hope. Some stockpickers are looking for earnings to surge 40% or more next year as the recovery spreads. One possible harbinger: NEC Corp.—1 of 144 Japanese ADRs—on Aug. 30 announced a strong pickup in Japanese personal-computer sales that should help its pretax profits increase 179% in the fiscal year ending next March.

If such tales of recovery were accompanied by suggestions of rapidly rising prices, traders would have every reason for concern. But with major central banks keeping world money growth to a modest rate, few economists see any sign of a major upsurge in overseas inflation anytime soon. And many offshore markets are simply cheaper than the U.S. now. "We're bullish on almost every market," says Peter Chambers, chief investment strategist at James Capel's London headquarters. "We're looking at a long, drawn-out, sustainable bull run."

Some money mavens are keen on the



Netherlands, home to such widely recommended ADRs as Unilever, Royal Dutch Petroleum, and Philips. Overall, Chambers expects Dutch profits to rise 22% this year. But in Amsterdam, he notes, stocks are only fetching 14 times 1994's anticipated earnings vs. 17 for the S&P 500. Hong Kong and Mexico, with p-e ratios of 13, are even cheaper.

HASSLE-FREE. These are hardly the only bourses where ADR values abound. Consider Italy. Beset by a weakening lira and political turmoil, it is nonetheless home to several high-quality companies. One big favorite is STET, the state-controlled phone company. Earmarked for privatization in coming months, it's selling for just 2.1 times its cash flow, a quarter of the multiple for AT&T. How about Israel? With Middle East peace spreading, Francis X. Gallagher, director of research at Oscar Gruss & Son Inc., is enthusiastic about Teva Pharmaceutical, a drug maker with a promising multiple sclerosis remedy undergoing tests.

DRUGS

Analysts favor Israel's Teva Pharmaceutical, which is testing a promising remedy for multiple sclerosis





Only a few years ago, tales from abroad such as these probably would have elicited blank stares from most U.S. investors. With investor interest in international equities barely apparent, U.S. brokers had little incentive to offer more than a meager selection of issues from such sources as African gold mines, stodgy European multinationals, and a smattering of other quirky issues. And most individuals would all but forget about trying to invest directly overseas.

Doing so usually meant the hassle of opening a foreign bank account and then paying big brokerage commissions, high foreign-exchange charges, and hefty local taxes. Things are little better today. Despite the spread of international investment, some countries, including Brazil, Chile, and Korea, still limit direct investment by foreigners. Even if they don't, most U.S. brokers charge stiff fees and maintain \$5,000 minimums on orders for foreign stocks. U.S. customers want to buy or sell abroad.

The beauty of the ADR is that it lets you get around all this hassle. As a result, many overseas companies aren't putting off the archaic rules of international investing to change. With long-established European and Asian multina-

RESOURCES

When Britain's Enterprise Oil tried to take over another producer, Lasmo, it offered blocks of ADRs to Americans

tionals and newly privatized developing-world companies all thirsting to tap U.S. investors for capital, they are now presenting themselves at Wall Street's doorstep. "We are aiming for an increased global presence in order to cut our capital costs," says Gerhard Liener, chief financial officer of German auto and aerospace

giant Daimler-Benz, which has seen U.S. shareholders snap up 10% of its equity since 1993, when it became the first German company to list its ADRs on the New York Stock Exchange.

Hundreds more ADRs have followed Daimler. Indeed, so popular have ADRs become, they rank among the most widely traded issues in the U.S. Some \$266 billion worth of ADRs are expected to change hands on the New York, American, and NASDAQ exchanges alone this year, the Bank of New York estimates.

Activity in such popular unlisted ADRs as Nestlé, Deutsche Bank, and Mexican retailer Cifra, which trade among brokers via "pink sheet" price lists and electronic bulletin boards, may account for an additional \$25 billion to \$50 billion worth of trading. Much to the chagrin of officials of bourses overseas, some ADR companies' issues trade more actively in the U.S. than at home.

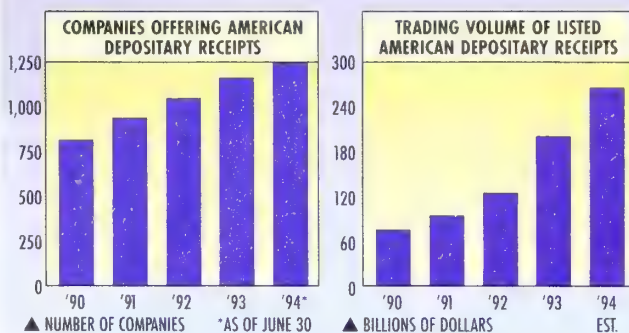
"LIQUID, LIQUID, LIQUID." One such issue is Telmex, the Mexican national phone company (page 102), whose ADRs went on the Big Board in 1991. Still the choice of many long-term Mexico enthusiasts for its high growth prospects and 9 p-e, "it's one of the great value plays," says William F. Truscott, Latin American portfolio manager at Scudder, Stevens & Clark Inc. Amid such endorsements, trading in Telmex has been humming along at some 4 million shares a day so far this year, putting it well on its way to becoming the exchange's most actively traded stock for the second year in a row. "American depositary receipts are liquid, liquid, liquid," says Eric J. Fry, a Mill Valley (Calif.) money manager and author of *International Investing with ADRs*.

All this commotion is over an instrument that gathered dust for most of its first seven decades of existence. According to market lore, the ADR was invented in 1927 by banker J. Pierpont Morgan, who was looking for a way to make it easier for Americans to own shares in Selfridge's Ltd., a big London retailer.

At the time, overseas owners of British and many other equities were obliged to present their share certificates to issuers before they could receive dividend checks. To do so meant taking a long ocean voyage to turn in certificates in person or shelling out a bundle to ship stocks to London and back several times a year.

Morgan, however, figured out a way to keep Selfridge's shares in custody offshore while allowing foreign owners to collect dividends with-

THE WORLD IS FLOCKING TO THE U.S. MARKET



DATA: BANK OF NEW YORK, CITIBANK

MODEL PORTFOLIOS FOR THE ADR INVESTOR

With more than 1,200 ADRs and other overseas stocks trading in the U.S., it's tough to choose among issues. So BUSINESS WEEK asked Morningstar Inc., the Chicago-based financial research house and publisher of the biweekly *Morningstar ADRs*, to assemble several portfolios.

	Price*	3-year annual profit growth	Price-earning ratio	Yield
STOCKS FOR GROWTH				
SMALL-CAPITALIZATION				
COTT (CANADA) Private-label bottler	\$10.38	132%	35	0.8%
BIG ROCK (CANADA) Brewer	14.13	37	61	0.0
DSG INTL. (HONG KONG) Diaper maker	28.25	33	18	0.7
GAMBRO (SWITZ.) Drugmaker	10.75	30	16	1.6
ANGLOVAAL (S. AFRICA) Conglomerate	2.73	28	39	1.1
LARGE-CAPITALIZATION				
BRIDGESTONE (JAPAN) Global tiremaker	156.41	85	47	0.7
PRUDENTIAL (BRITAIN) Mammoth insurer	24.77	52	16	3.9
GENTING (MALAYSIA) Hotel operator	14.33	28	36	0.5
CHINA LIGHT & POWER (H.K.) Utility	4.98	22	22	2.6
JUSCO (JAPAN) Supermarket group	241.75	20	31	0.8
VALUE STOCKS				
SMALL-CAPITALIZATION				
UNITED DOMINION (CANADA) Machinery	18.88	186	20	1.1
ALADDIN KNOWLEDGE (ISRAEL) Software	8.13	105	19	0.0
EK CHOR (CHINA) Motorcycles	21.63	81	16	0.5
TECHOMATIX (ISRAEL) Software	6.25	81	18	0.0
FAIRHAVEN INTL. (BRITAIN) Construction	0.38	62	3	5.3
LARGE-CAPITALIZATION				
HANG SENG BANK (H.K.) Big local lender	6.66	50	15	3.2
B.A.T. INDUSTRIES (BRITAIN) Tobacco, insurance	13.00	48	11	4.6
NATIONAL WESTMINSTER (BRITAIN) Bank	44.88	39	14	3.7
TELEFONOS DE MEXICO (MEXICO) Phones	65.75	32	12	2.5
POWERGEN (BRITAIN) Utility	88.56	24	13	2.2
YIELD PLAYS				
GREAT WALL (H.K.) Electronics	5.75	44	5	9.0
S. CHINA MORNING POST (H.K.) Newspapers	3.00	22	14	6.3
BANCO SANTANDER (SPAIN) Leading bank	39.88	15	9	5.7
BRASCAN (CANADA) Mining, finance, energy	14.13	36	18	5.7
BURNS, PHILIP (AUSTRALIA) Food	13.72	4	13	5.3
NATURAL RESOURCES				
AMPOLEX (AUSTRALIA) Energy	3.11	106	12	1.3
AMERICAN BARRICK (CANADA) Gold	22.00	55	29	0.4
WOODSIDE PETROLEUM (AUSTRALIA) Oil	3.44	21	43	1.5
DREIFONTEIN (S. AFRICA) Gold	15.25	17	13	4.5
ROYAL DUTCH PETROLEUM (NETH.) Oil	109.63	16	17	4.4
EMERGING MARKETS				
CREATIVE TECHNOLOGY (SING.) Electronics	17.25	103	16	0.0
SELANGOR (MALAYSIA) Real estate	1.22	91	41	0.8
GRUPO SIMEC (MEXICO) Steel	28.88	54	21	0.0
PEREGRINE (H.K.) Securities	3.58	53	8	4.5
TOLMEX (MEXICO) Cement	147.52	49	18	0.8

* August 23, 1994

DATA: MORNINGSTAR INC.

out hassle. His solution was simple and elegant: It was to create a receipt—an ADR—for shares it held in custody abroad. Using this loophole let Morgan pass dividends and annual reports on to overseas shareholders, freeing them from the expense of obtaining them on their own.

INTERNAL MARKET. Morgan's solution has persisted to this day and comes into play every time an ADR is created. When a U.S. broker gets a request for 100 shares in, say, British Petroleum Co., he passes on the order to his firm's trading desk or another securities dealer in London. The London trader buys the BP stock and ships the certificates to the local branch of a U.S. bank for safekeeping. The branch then tells its New York headquarters to issue receipts for the shares and deliver them to the U.S. broker, who sends them on to the investor much as he would certificates of any American stock. When it's time to sell the shares, the broker simply runs the transaction in reverse. Whether it's in London, Bangkok, or Johannesburg, the process is always the same.

While this entire chain of transactions can be completed in the five days it normally takes U.S. stock trades to clear, investors usually don't need to face even this delay anymore. That's because so many ADRs are now in circulation in the U.S. that most of the time, brokers don't even need to trade overseas. Instead, they simply match up buy and sell orders on a major U.S. exchange or fill orders from their own inventories of ADRs. Says Merrill's Barth: "You can get 100 shares of any ADR right now."

ADRs carry the same voting powers as the overseas shares they represent. They also may let you participate in rights offerings, which are very common abroad, if the company chooses to register them with the Securities & Exchange Commission. Rights offerings, which are similar to call options or warrants, give existing shareholders a chance to purchase shares of a company's stock at a discount from their current price. When a company does not register a rights offering with the SEC, the ADR bank sells the rights overseas and sends you a check, in dollars, for their value.

The use of ADRs has become so sophisticated that many securities houses now sell vast blocks of them in the U.S. to finance privatizations and even pay for takeovers. That is giving the U.S. securities industry an important edge over its offshore competitors. ADR investors provided most of the cash for the \$3 billion privatization of Argentina's state oil company, YPF, when a group of investment banks took it public in 1993. And Britain's Enterprise Oil PLC offered

HIGH TECH

These days, international blue chips such as Japan's Hitachi are trading right alongside AT&T and General Electric

American shareholders ADRs in its unsuccessful bid to take over LASMO PLC, another North Sea independent producer, earlier this summer.

But despite their wide acceptance and close resemblance to domestic stocks, ADRs are overseas equities at their heart. As such, they pose a special set of risks that sometimes can trap even the most highly skilled investor.

No. 1 is currency risk. Although ADRs trade in dollars, they represent shares that are actually denominated in Japanese yen, German marks, Brazilian reals, or other currencies. So a sharp move in the dollar against the currency of an investor's home country can produce spectacular returns—or losses—in no time at all.

Take NEC. Hopes for an economic rebound have pushed the electronics maker's stock up 33% on the Tokyo Stock Exchange this year. But NEC's U.S. shareholders did far better. The yen's sharp rise against the dollar has helped NEC ADRs—which are quoted in greenbacks—by an eye-popping 50%.

Of course, the part of the gain generated by the currency move could be quickly unwound if the dollar recovers, as some economists think likely. In any event, the gyrations of the dollar probably will make less of a difference over the long haul than NEC's basic business strategy—which is to remain competitive around the yen's current level of value to the dollar. While a move in the dollar would hurt NEC's ADRs, the move would help the company's exports and provide some relief from the yen shock it has faced this year.

ROLLER COASTER. The outcome thus might turn out to be a wash. In fact, that's why Glenn R. Carlson, a managing director of San Diego-based Brandes Investment Partners, never hedges currency exposures. "Since 1980, the dollar has been all over the place, and in the long term it has evened itself out," says Carlson. Hedging is very important if you have a short time horizon. But in the long run, it doesn't have much impact."

Political risk is another important con-



cern. Earlier this year, the Mexican stock market was badly shaken by a peasant revolt and the assassination of leading presidential candidate Luis Donaldo Colosio. Brazil's bourse has likewise undergone some stomach-turning ups and downs. The São Paulo market plunged nearly 50% from February to May amid investors' concerns over strong showings in voter polls by Luis Inacio Lula da Silva, the Socialist presidential candidate in this fall's elections. The index then soared 120% over the next three months as Lula's conservative opponent, Fernando Henrique Cardoso, moved into the

lead on the back of a tough anti-inflation and currency-reform plan. But on Sept. 5, the market dropped 11% after Finance Minister Rubens Ricupero resigned. Ricupero, an ally of Cardoso, unwittingly conceded on nationwide television that he hides bad economic news from the public. "I don't have any scruples," he told shocked TV viewers. Among the ADRs riding the roller coaster was Telebrás, Brazil's national telephone company. Telebrás is expected to benefit mightily if Cardoso wins the election and starts privatizing the country's telephone service. Still, Carlson warns, "it's the most volatile stock on the face of the earth."

INFORMATION GAP. Another problem facing ADR investors is taxes. Governments overseas often levy stiff withholding taxes on ADR dividends to make sure they get their due. The taxes—35% in India and 15% or more in Britain—are deducted before dividend checks are sent out, cutting into yields. The banks that handle ADRs provide shareholders with annual statements detailing how much was withheld. But to recover the sums, you must re-

quest a credit with the Internal Revenue Service when filing your taxes.

If tax hassles were not enough, ADR investors also have to cope with an information gap. Fortunately, the SEC requires that companies offering ADRs on American exchanges adopt U.S. accounting standards—several Chinese manufacturers and the New Zealand forest-products con-



RETAILING

Mexico's Cifra, which has a joint venture with Wal-Mart, is among the foreign retailers Americans are investing in

glomerate Fletcher Challenge Ltd. are among them—or at least explain the difference between their domestic results and what they would have been if reported along U.S. lines. That can produce some surprises, not all of them pleasant. On Aug. 31, for example, Daimler Benz reported first-half profits of \$294 million in Germany. But when Daimler recast its results along U.S. lines, its

earnings were nearly \$60 million lower.

For the pink-sheet ADRs, however, such comparisons are usually unavailable. Because they are not traded on exchanges, the SEC frees the companies from having to follow U.S. accounting and reporting requirements. But some companies are dramatically improving their disclosure in hopes of winning a greater following abroad. At Nestlé, where 15%

of its shareholders are Americans, “have gone to half-year reports, segment reports, and we are improving our cash flow reporting,” says Executive Vice-President Reto F. Domeniconi. “Every year we’re improving a little bit.”

Even if overseas companies did report their results along U.S. standards, following their health day-to-day can sometimes be a vexing challenge. While *The Wall*

WILL RIVALS UNPLUG TELMEX? DON'T BET ON IT

Every time it rains, the inhabitants of Republica de Cuba 12, an apartment building on the edge of Mexico City's colonial center, lose their telephone service. After one recent storm, repairmen crossed the building's lines so badly that tenants began receiving calls for other apartments. One enterprising resident compiled a list showing which number matched which apartment, so occupants could redirect bewildered callers.

Tales like these reinforce the dismal image millions of Mexicans have of the country's telephone monopoly, Teléfonos de México (Telmex). But those stories didn't bother investors much. Since the company's American depositary receipts were listed in 1991, following the company's privatization the year before, Telmex' share price has climbed 120%, fueled by 40%-plus operating margins. Now, investors are paying attention. For the first time ever, Telmex faces competition.

JITTERS. Later this year, Mexico's government is expected to announce rules for entering the \$4.2 billion long-distance market after Telmex' long-distance monopoly expires in 1997. Among probable bidders: MCI Communications Corp., which has formed a joint venture with Mexico's largest financial group, Grupo Financiero Banamex, and Sprint Corp., which announced an agreement with Mexican cellular-phone operator Grupo Iusacell in late July. Iusacell, whose ADRs have risen 9% since their listing in June, already has a mighty partner: Bell Atlantic Corp. completed purchasing a 42% holding in the Mexican company last month.

Worries about competition have contributed to Telmex' sluggish performance this year. The stock, which accounts for about a quarter of the Mexican market's capitalization, lags behind the rest of the *Bolsa*. In part, that's because foreign investors have gone shopping for new stories since the passage of the North American Free Trade Agreement heightened interest in Mexican ADRs. Telmex ADRs

All of which makes Telmex, now trading at about nine times estimated 1995 earnings, a bargain in some analysts' eyes. “I think all the unknowns about competition are already discounted into the stock,” says Andrew Friedman, a telecommunications analyst at Vector Casa de Bolsa in Mexico City. “It's going to keep making money. And with unrest subsiding and the country's economic reforms assured,

since Ernesto Zedillo Ponce de Leon's presidential win, investors are looking to get back into Mexico—and Telmex. Ricardo Peón, a telecom analyst at Baring Securities Inc., figures Telmex' earnings are likely to grow by 15% a year through the year 2000.

Telmex is trying to make sure such rosy earnings predictions pan out. This year alone, it plans to spend \$2.2 billion on upgrading its network. Two thirds of its lines are already digital, and all lines in Mexico's five

major cities should be digital by the end of 1995. The company has also been gradually raising rates for basic service, which now accounts for about 43% of revenues, while bringing down long-distance rates to avoid a sudden drop when competition comes. Even then, the increased volume generated by lower rates may make up for some of the eventual loss in market share to new competitors. Lately, Telmex has begun focusing on service for corporate clients, who could be the first to bolt when competition begins in 1997. Telmex wants to make sure they won't forget who they're dealing with once its rivals arrive.

By Elisabeth Malkin in Mexico City



CROSSED LINES: DESPITE DISMAL SERVICE, TELMEX SAW A 120% SHARE GAIN

are still down 14% for the year. It has also suffered disproportionately from Mexico's political turmoil.

But political jitters have abated in the wake of August's presidential elections. The economy appears to be picking up. And new competition isn't likely to pose much of a threat for Telmex. Potential competitors don't know if they will be able to bid for Telmex' lucrative international service as well as a share of the growing domestic long-distance market. They also don't know whether they will have to pay an entry fee or submit a formal bid. They don't even know how many competitors the government will welcome into the fray.

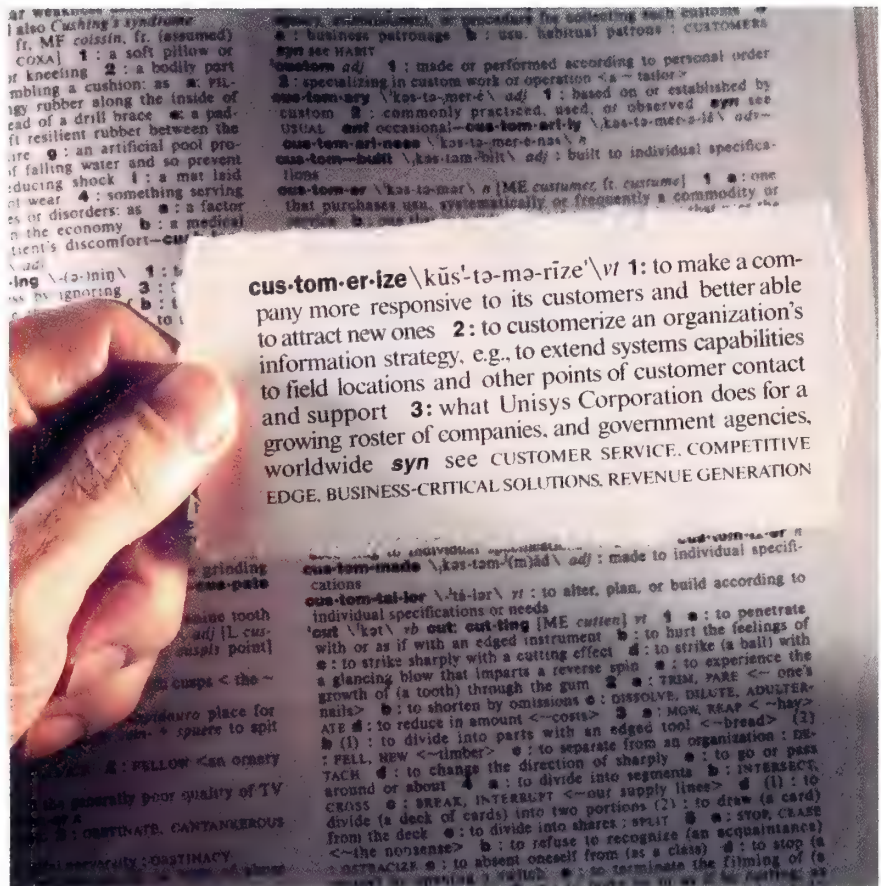
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and search through a database of hundreds of publications, including *The Wall Street Journal* and *Barrons*, for news on foreign companies. If you need more or need to use DJ during the day, you can venture into the full Dow Jones News/Retrieval service at regular rates—a hefty \$1.50 for 1,000 characters of information, about two-thirds of your computer screen.

Another extensive source is CompuServe Inc. But count on spending at least \$9.60 an hour for "extended" services and probably much more if you're serious about foreign stocks.

Global Report, a collection of news wires including Britain's Financial Times, France's AFP, and Japan's Kyodo, costs \$30 an hour extra after 7 p.m. and twice that during the day.

The up-and-comer is Reuters Money Network, a product of Reuters Holdings PLC, Dow's British rival. If you don't like spending hours

browsing on-line, this is for you. You specify the companies and industries you're interested in, and your computer calls Reuters and fetches quotes, tables, reports, and news in batches. Everything is then displayed in a clever newspaper format. The basic service is \$12.95 per month. News and fundamental analysis is \$9.95 a month more.

Money Network is still thin on foreign news. But by yearend, it will offer the full Reuters international news and quote feed. You'll be able to click your mouse on major global exchanges, type in a stock symbol, and download the goods on overseas companies.

It's easy to sample services before you sign up. With the exception of Dow Jones, most of them offer trial runs, usually for the cost of the start-up software. So set aside a weekend or two to go global on the Infopike, and see how much you can unearth. You'll be surprised at how far you can expand your horizons—not to mention your portfolio.

By Larry Armstrong in Los Angeles

Street Journal and *The New York Times* carry a fair amount of news about the biggest ADR companies, hundreds more escape notice. Big U.S. brokers typically maintain databases on many ADRs—Dea Witter Reynolds Inc. even has teamed up with London's S.G. Warburg & Co. to help investors follow overseas stocks.

Other investors are logging on to on-line information systems (page 104) which increasingly have a global focus, or subscribing to *Morningstar ADRs*, a biweekly offering news, prices, and analysis on 700 leading international companies. But to keep up with things, many international investors turn to *The Financial Times*, the British daily newspaper that is distributed worldwide, or for low such specialized regional English-language papers as *The Asian Wall Street Journal*, Hong Kong's *South China Morning Post*, Japan's *Nikkei Weekly*, or the *Lagniappe Letter*, a biweekly publication on Latin America.

BAD HABITS. Even reading such specialized publications may not keep you up on all the foibles of corporate management overseas. It's especially important to keep an eye out for developments in emerging economy companies that have little experience with international markets. In China, for example, companies have developed a habit of going off in odd directions with little warning. Take Shanghai Erfangji, a maker of textile machinery whose ADRs have won a modest following. Erfangji has perplexed analysts with its plans to expand into such fields as fast-food franchising and commercial property development. "It worries me to see a company go into areas in which it has no expertise," says Queenie Cheung, an analyst with Standard Chartered Bank in Hong Kong. "Their rationale is to diversify their earnings base, but I don't think the company has the funds."

For the most part, investors have been willing to put up with such quirks because the returns on international investing have been so robust. That's certainly the experience of legendary global investor John M. Templeton, whose Templeton World Fund has outperformed the S&P for decades. Now, the spread of ADRs permitting more and more investors in individual stocks to emulate Templeton, for example. "ADRs are the best way to invest overseas," cheers author and money manager Fry. For the stock-picker looking for a way to diversify around the world, that's certainly sound advice.

By William Glasgall in New York, with Dave Lindorff in Hong Kong

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services offer quotes and information on "pink sheet" ADRs traded over the counter. "It turns out that these thinly traded stocks are exactly what small investors are looking for," says Chris Hill, who heads up personal investor products for IDD Information Services. **HEFTY FEES.** For listed ADRs, the premier information service remains Dow Jones News/Retrieval. "Without question, it is the best and most exhaustive service for the individual investor," says Robert Schwabach, author of *The Business Week Guide to Global Investments Using Electronic Tools*, published by Osborne/McGraw-Hill. Dow's Market Monitor service costs \$29.95 for eight hours of access a month, and additional hours are \$3.60. The catch? You can't use it before 7:01 p.m. weekdays, and it puts some limits on the information you can download. Stock price and performance histories, for example, go back only two years.

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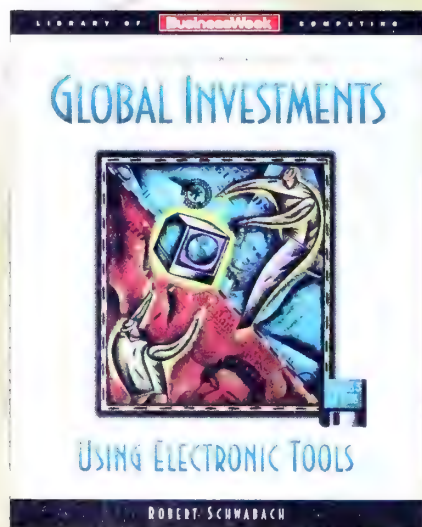
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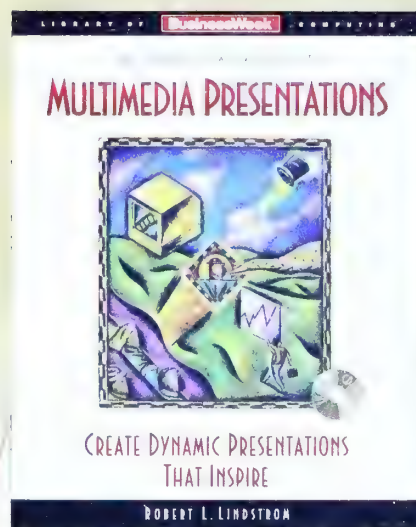
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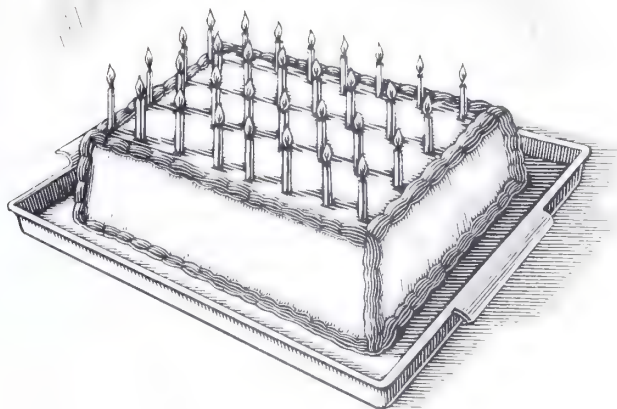
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A NEW, IMPROVED RETIREMENT PLAY?

Hundreds of companies bet on a supposedly safer version of GICs

When Canada's Confederation Life Insurance Co. failed last month, it sent shivers down the spines of retirement-plan managers on the U.S. side of the border as well. Ontario-based Confederation, Canada's fourth-largest insurer, has suspended principal and interest payments on about \$1 billion worth of guaranteed investment contracts (GICs) it peddled to fund managers in the U.S., including Fidelity Investments and Bankers Trust. Many retirement plans may suffer millions of dollars in lost principal or reduced interest payments or both.

The Confederation episode is just the latest in a string of insurance-company failures that has prompted many plan sponsors to turn away from traditional GICs. These are fixed-income investments in which the issuer, usually an insurance company, guarantees a fixed return for up to five years and repayment of principal. The contracts, whose returns are significantly higher than maturities of similar maturities, have long been the most popular investment option for employees, accounting for a third of the \$750 billion in retirement plans, mostly 401(k) plans, in which em-

ployees make their own investments.

Now, retirement plans by the hundreds are turning to a new breed of GIC—the "synthetic" GIC, which shields companies from insurer insolvency. In contrast to traditional GICs, in which an insurer commingles plan funds with other managed assets, new GICs call for the plan sponsor to retain ownership of the assets. To maintain the principal pro-

REJIGGING THE RISK

TRADITIONAL GICs

Company gives employee retirement money to an insurer, which invests funds in a fixed-income portfolio and guarantees a set return. But if insurer becomes insolvent, as has happened several times in recent years, retirees can lose money.

"SYNTHETIC" GICs

Company retains control of retirement funds and hires a fixed-income manager. Insurer writes a "wrapper" that protects against loss of principal.

DATA: BUSINESS WEEK

tection of the old GICs, plan sponsors using new GICs purchase a "wrapper," or guarantee from a bank or insurer, to ensure that employees can withdraw their original principal at any time. If a withdrawal takes place at a time when the portfolio is valued below book, the guarantor makes up the difference. (If it's above book, the guarantor keeps the surplus.) The wrapper usually costs from 0.15% to 0.25% of total assets. While quoted returns on new GICs change more frequently, new GICs generally offer higher returns than old ones—about 50 basis points on five-year contracts, says C. Jason Psome, a director at investment firm Sanford C. Bernstein & Co.

"SEA CHANGE." Also spurring the move to new GICs was last spring's bond market collapse. Companies with managed fixed-income portfolios suffered huge losses. And many employees were shocked to see negative rates of return, because, unlike GICs, which can use book-value accounting, these portfolios had to report current market prices.

"There's an orderly liquidation of traditional GICs going on," says David L. Eager of Louisville-based D.L. Eager Associates Inc., an investment management consultant. "Plans aren't rushing to dump them, but as they expire, they're being replaced with synthetics." Bernstein's Psome calls this development "nothing less than a sea change."

One convert is Donald J. Butt, manager of trust investments at US West Inc. in Englewood, Colo., who was worried by the rash of insurer insolvencies. Butt now uses three fund managers, including Wells Fargo Nikko Investment Advisors, Payden & Rygel Investment Counsel, and Jennison Associates Capital, and buys his wrappers from Bankers Trust and Provident Insurance. According to Butt, one-third of the company's \$442 million interest-income fund now consists of new GICs. Says Butt: "You select the wrapper as well as the investment manager and can hire and fire them at will."

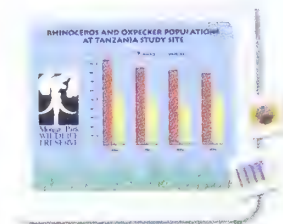
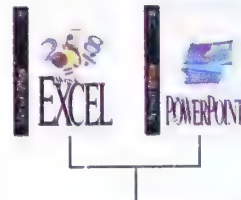
Reynolds & Reynolds Co., a Dayton information-management concern, has shifted \$53 million of old GICs, or half of the company's entire 401(k) plan assets, into new GICs because of its concern about fluctuating bond prices. "Our participants look at their 401(k) as if it's a passbook bank account," says Craig L. Currier, director of corporate pension

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plans. "And in a passbook account, you don't see unrealized gain or loss on your monthly statement." With a new GIC, "you're not worried about the credit quality of the insurer," he says.

Yet continuing controversy over exotic financial instruments has made many plan sponsors more cautious. At Cleveland-based American Greetings Corp., where about 20% of the defined-contribution assets are invested in GICs, Treasurer Dale A. Cable worries about the difficulties of educating plan participants

about such investments. He says he would probably shy away from new GICs or "any specialized or technical investment product," adding that "we try not to get too exotic." By sticking to large, top-rated insurers, Cable says, he can cut the risk of default.

EVEN TRADE? To be sure, new GICs haven't eliminated risk entirely. In effect, says Marjorie Zwick, a principal at benefits consultant William M. Mercer Inc., "you're [exchanging] the credit risk of the insurance company for other risks,"

such as more frequent changes in promised returns. While new GICs appear to be an improvement over the old ones, "some [of the new investments] haven't been tested in a long-term rising-interest-rate market," says Zwick.

Although the new GICs may have their flaws, they do give companies one big plus: a lot more control over their retirement funds' financial destiny.

By Jeffrey M. Laderman, Phillip L. Zweig, and Suzanne Woolley in New York with bureau reports

INSURANCE

YOUR DOCTOR'S BOSS MAY BE AN INSURANCE COMPANY

As carriers acquire medical practices, critics fret care may suffer

The hassles were getting to Dr. Ruth DuPont. Steep malpractice premiums, labyrinthine billing systems, and mounting paperwork were taking a big toll on the family physician's time, not to mention her finances. So last fall, DuPont took a step many physicians consider heretical: She signed on with Aetna Life & Casualty. By becoming an employee in Aetna's growing network of doctors, DuPont shed tiresome, costly administrative chores in one fell swoop.

Physicians such as DuPont are becoming hot commodities. Over the past two years, hospitals have been buying up doctors' practices aggressively, sucking doctors out of insurer-run managed-care networks and signing them up as employees. By cementing ties with doctors, hospitals gain leverage in the changing health-care arena. Now, insurers are fighting back, buying or building practices to secure a flow of patient revenues and avoid being cut out of the loop by health-care alliances. "If insurers don't do this quickly, they'll be out of the business," says Samuel H. Havens, president of group operations at Prudential Insurance Co. of America.

TIGHTER GRIP. Insurers seem to agree. Aetna will open as many as 60 medical centers in seven urban areas by next June. CIGNA Corp. plans to spend \$150 million to buy or open 400 centers. Blue Cross & Blue Shield of New Jersey announced in mid-May that it would open

10 offices by yearend. Prudential, Foundation Health, and Healthsource recently bought or are managing practices.

Whether the strategy will pay off is far from clear. Although an Aetna HealthWays office in Dallas is full of patients, doctors at Aetna's six Atlanta offices, open for almost a year, are each seeing only 15 patients a day—60% of

Medical Assn. The inference: Doctors may feel even more pressure to focus on the bottom line at the expense of patients than they already do in managed care networks, since the new setup removes the last vestige of operational independence. Stephen C. Caulfield, managing partner at benefits-consulting firm William M. Mercer Inc., worries that doctors will be rewarded for herding patients "through offices like cattle." One doctor, urged to spend less time with patients, says she was "dancing as fast as I could." The quality of her care suffered, she says, and she eventually left the insurer group.

IN THE DARK. Insurers reject such criticism. "Our future is in providing care where it's of high quality," says Michael A. Stocker, president of CIGNA Health plan Inc. Some doctors praise the setup for its flexibility: When Aetna doctors balked at a \$260 bill for lab work,

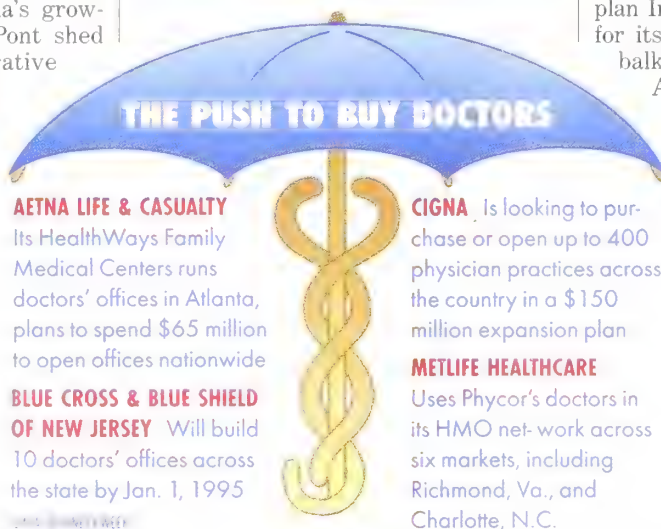
Aetna negotiated to get the bill reduced to \$87. And insurers say they are opening new offices in rural and growing areas that badly need doctors.

What seems to bother critics most is that many patients aren't aware of the relationship between their doctor and their insurer. CIGNA places its name on a doctor's office only in certain cases, depending on whether the doctor's name CIGNA's carries more clout. A spokesman says Aetna picked a new brand name for its offices because "people react more positively in surveys

HealthWays than the Aetna name."

It's not surprising that many people feel uneasy about their doctor's boss being an insurer. "It gives me an uncomfortable feeling," says David A. Szymanski, a patient in a Tampa office run by CIGNA. That vague distrust is something insurers will have to contend with in their quest for doctors—and patients will have to deal with in their quest for the best-quality care.

By Chris Roush in Atlanta



the typical volume. Aetna has yet to see a profit. In an attempt to add patients, it is handing out coupons to local employers that waive insurance co-payments for HealthWays patients.

Meanwhile, critics say insurers' tightening grip on doctors could affect the quality of care. "We are concerned that the future market is likely to be dominated by insurance companies," says Edward B. Hirshfeld, associate general counsel for health law at the American

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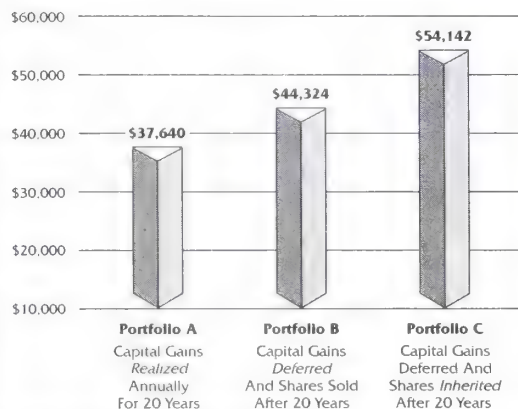
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A BANK BOSS AT THE BRINK

Regulators and shareholders take aim at Michigan National's CEO



MYLOD: CRITICS BLAME HIM FOR THE BANK'S ABYSMAL 0.2% RETURN ON ASSETS

The post of chief executive officer of a bank is not exactly a tenured position, but it usually offers more job security than most top jobs in Corporate America. That makes the perilous plight of Robert J. Mylod, CEO of Michigan National Corp., if not unique, highly unusual. Just about everyone, it seems, wants him out.

Michigan National, a decade ago one of the most aggressive and innovative banks in the Midwest, is now among the most vulnerable. Its financial performance has been so poor that officials from the Comptroller of the Currency have forced Mylod to agree to accept closer oversight of the bank—at a time when most other banks have been generating record results.

COUP AT HAND? Shareholders are up in arms. Professional investors such as Michael F. Price of Heine Securities Corp., which holds 5.5% of Michigan National's stock, have denounced Mylod's performance. Other outspoken critics include Frederick A. Erb, a retired MNC board member, and Stanford C. Stoddard, Mylod's predecessor, who was ousted from the bank in 1984. At a contentious annual meeting last April, fully one-third of the votes cast failed to support the reelection of the board of direc-

tors, which was running unopposed.

The MNC board is up for reelection next spring, and some observers are predicting a proxy fight. Others foresee a takeover. Price, for one, has called for a sale of MNC. As the state's third-largest bank, MNC would represent a major beachhead in the thriving Michigan market, which so far has kept most out-of-state banks at bay. Analysts say potential acquirers include Norwest and First Bank System of Minneapolis; Banc One, KeyCorp, and National City of Ohio; and PNC Bank of Pittsburgh.

Mylod, the tall, intense former president of the Federal National Mortgage Assn., who almost never attends industry events, is finally making changes. But, says Denis Laplante, a banking analyst at Fox-Pitt Kelton Inc., "It may be too little too late." Mylod and other MNC officers declined to be interviewed.

New management could hardly do worse than Mylod. When he took over, he pledged to push return on equity, then at 9%, up to 17% by 1988. It did rise to

29% in 1988, but only with help from selling the bank's credit-card business. ROE has since plummeted, to a scant 3% in 1993. Return on assets, at a dismal 0.2%, was the lowest of the 61 U.S. banks with more than \$10 billion in assets.

These poor results stem largely from decisions by Mylod. One example: MNC's push, beginning in 1987, to get into mortgage servicing, the back-office processing of mortgage loans. With the recent wave of refinancing, mortgage loans have been rapidly retired and the value of the right to service them has fallen precipitously. MNC has taken write-downs of \$186 million on mortgage-servicing rights.

Expenses have been another big problem. Most big banks run on efficiency ratios—the ratio of operating expenses to revenues—of between 60% and 65%, according to investment bankers Keefe, Bruyette & Woods Inc. Lacking decent cost-control systems, MNC's efficiency ratio was 87% in 1993. It was while these high costs were being booked along with low profits that regulators tightened their scrutiny.

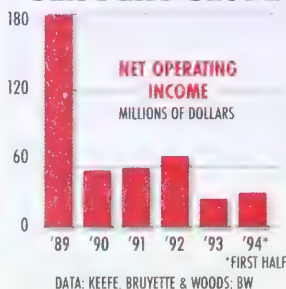
A SHAKY FUTURE. This year, Mylod has at last begun working to improve MNC. He brought in Douglas E. Ebert and Joseph J. Whiteside as chief operating officer and chief financial officer, respectively. Both have experience in turning around troubled banks—and selling them. Mylod has also retained investment bankers Keefe, Bruyette & Woods for general financial advice. He has sold MNC's Texas operations, and hired consultant and cost-cutting expert Chandrika Tandon of Tandon Capital Associates Inc. The bank's results are improving. Second-quarter operating earnings rose to \$23.1 million, up from \$18.3 million in the first quarter.

Still, skeptics about the bank's future abound. "The same people who took [shareholders] into this mess are the ones saying: 'We'll take you out of it now,'" fumes former CEO Stoddard. "They aren't listening to the shareholders; they're listening to themselves."

With MNC shares trading up smartly this year, investors are reaping a reward. But analysts such as Bear, Stearns & Co.'s Michael K. Diana say the rise is due mainly to takeover speculation. With another unruly annual meeting looming, the betting is that Mylod won't be around to enjoy the benefits of housecleaning.

By James B. Treece in Detroit

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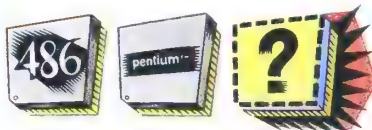
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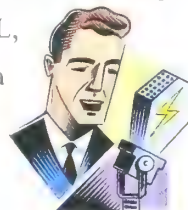
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Finance

MARKETS



RUSSIA FIRES A NEW SHOT AT THE DEFICIT

A hot T-bill market may help to tame inflation

Staring at the numbers flashing across his computer screen, Alexei Kurdukov whispers into his cradled receiver, listens, then types a series of numbers. "They bit!" he yells a few minutes later. Kurdukov, a 22-year-old senior trader for Troika Dialog Investment Co., has just sold \$38,400 worth of three-month Russian Treasury bills.

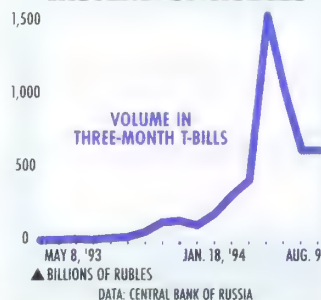
Russia has quietly been building an important capitalist foundation: a T-bill market. Although tiny compared with the \$714 billion of short-term U.S. Treasury bills outstanding, the Russian market is growing rapidly (chart) and could turn into a much-needed inflation-fighting tool for President Boris Yeltsin. The new market soaks up liquidity and lets the government finance its \$10.5 billion deficit by raising capital rather than by printing ever more rubles.

The willingness of investors—mostly domestic banks and insur-

ers—to buy the bills in Russia's unruly economy is a sign of growing confidence that the government is making inroads against inflation. Indeed, monthly inflation is down to 4.6%, versus 29% a year ago. Still, the ruble-denominated, zero coupon bonds carry heavy yields, equivalent to 25% to 30% in hard-currency terms.

Western bankers give the Central Bank of Russia credit for creating an efficient market. For two hours each weekday, Kurdukov and 54 other dealers share a room at the Moscow Interbank Currency Exchange (Micex), near Gorky Park, and trade Russian government securities by computer. All T-bill trading is done electronically under supervision of the central bank, which, as in more developed markets, may intervene by buying bills. "It's the only real, liquid securities market today in Russia," says Miljenko Horvat, president of Citi-

PUMPING OUT DEBT INSTEAD OF RUBLES





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Finance

bank in Moscow. Russia's fledgling stock market has little liquidity and is tainted by scandals such as the MMM pyramid scheme. And there's no corporate bond market to speak of so far.

T-bill revenues have already made a dent in the deficit. Since the first auction in May, 1993, more than \$1.5 billion has been transferred to government coffers. Over \$2.25 billion of three- and six-month bills are in circulation, and daily trading volume in the secondary market exceeds \$25 million. Encouraged by this success, the government plans to increase the frequency and size of auctions, broaden the distribution network and interest investors in longer-term securities: An auction of one-year bills is set for September.

The government also plans to turn to the capital markets to help solve the \$25 billion problem of interenterprise debt. Starting next month, central bank branches across Russia will begin selling \$600,000 worth of one-year bonds. The government will use the revenue to pay off its debt to enterprises. The theory is that once factory managers receive the money the government owes them, they can pay their debts to each other. The new financing is intended to help halt the vicious circle of debt hobbling the government and state-owned enterprises.

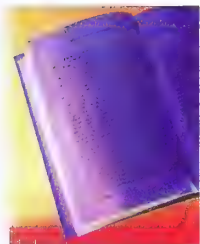
HIGH EXPECTATIONS. But given Russia's chaotic economy, longer-term securities may not be popular. In fact, the most recent auction of six-month bills was undersubscribed by 42%. "If the government wants to increase its long-term securities, it will have to offer much higher returns," says Victor Huaco, president of LTS Finance, a Moscow-based financial boutique set up with foreign capital.

So far, foreign investors have only dipped their toes in the Russian T-bill market. That's partly because dealers are prohibited from selling more than 10% of their T-bill portfolio to foreigners. But some Western bankers feel the risks of investing in government debt may outweigh the potential rewards. "The T-bill market in Russia is probably the most adventurous of any fixed-income emerging market we've looked at," says Dirk Damrau, director of emerging markets research at Salomon Brothers in London.

If Yeltsin continues to prop up failing enterprises with subsidies, he could undermine the T-bill market's inflation-busting potential. Like bond markets the world over, this one will demand higher yields if inflation expectations rise. But with more and bigger auctions ahead, the central bank is clearly convinced that buyers will keep on biting.

By Patricia Kranz in Moscow

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COMPUTERS, COMMUNICATIONS, MICROELECTRONICS

BY GENE G. MARCIAL

A RED-TAG SPECIAL AT MERCANTILE STORES?

The retail trade might call Mercantile Stores a slow mover. But lately, the shares have become too cheap to ignore: They fell from 41 in March to 30 in June—before moving back up to 38 on Sept. 6.

"Mercantile's stock has been on its keister for years," notes Ted Aronson, managing partner at Philadelphia's Aronson & Fogler, which shepherds some \$1 billion. "But it's my kind of a stock," he adds, "trading below book value and selling at rock-bottom multiples of assets and earnings—in spite of a decent management." Analysts put Mercantile's 1995 book value at more than \$40 a share.

A couple of very large chains—Dillard Department Stores and May Department Stores—have noted the market's undervaluation of Mercantile, which operates some 100 stores, mostly located in the South and Midwest. The company posted 1993 sales of \$2.7 billion. One industry insider says both Dillard and May have approached Mercantile about the possibility of a merger or buyout.

No deal is possible unless the Milliken family, which owns some 40% of the stock, agrees. Roger Milliken, head of the family and a Mercantile board member, has long resisted a sale. But now in his late 70s, he has had a change of heart, says a New York money manager who has been buying the shares. The Millikens, who also own a textile company in Spartanburg, S.C., have rejected one "tentative and unofficial \$50-a-share offer" from another major chain, says this source.

DYNASTY. "Milliken is now willing to sell the family's stake at a price closer to \$60 a share," says this source. Two other family members on the board—Gerrish, a brother of Roger Milliken, and Minot, a cousin—are expected to go along with the patriarch. Mercantile Treasurer William Carr says he's aware of the rumors but that, as a matter of policy, the company won't comment on them. Calls to Roger Milliken, Dillard, and May weren't returned.

Dillard, which operates 227 stores in 20 states, mainly in Florida, Louisiana, Missouri, and Texas, posted reve-

MERCANTILE: AT A PREMIUM IN A BUYOUT



nues in 1993 of \$5.1 billion. May, whose 201 stores include Lord & Taylor and Filene's Basement, reported revenues last year of \$11.5 billion.

Analysts note that Mercantile has been losing market share. They say a comparison of same-store sales shows volume on the decline. As a result, profits have been lackluster. Earnings of \$2.36 a share for the year ended Jan. 31, 1994, were no improvement on the year before. In 1995, analysts expect \$2.70 to \$2.80.

REALLY GETTING THE LEAD OUT

Investment adviser Tom Fendrich has made a big bet on Integrated Resources Technologies to get a jump on lead. The company is in the business of removing and hauling asbestos and lead from public and private buildings.

The Environmental Protection Agency, he notes, has set stringent lead-removal guidelines, based on evidence that lead exposure is immediately toxic—even at low levels. For Integrated, the real kick is the projected earnings stream from lead-removal contracts. The initial impact of the regulations, which take effect next year, will be on houses and buildings for sale. They will need to be free of lead paint. A lot of remedial work will be needed, which is estimated by experts to amount to billions of dollars, says Fendrich. "Starting next year, the removal of lead-based paint from buildings will be a huge business, and Integrated will be a pure play in it," says Fendrich, who

has been accumulating shares, trading now at 2.

He figures Integrated's revenues will jump from \$7 million for the year ended Apr. 30, 1994, to \$11 million for fiscal 1995. Earnings, he figures, will soar to 50¢ a share next year, up from 3¢ in 1994. By 1996, Fendrich expects the full impact of lead and asbestos work to hit the bottom line, and he sees earnings of 75¢. The stock price, he believes, will reach 8 in two years.

OUT IN FRONT AT THE TRAILER PARK

Something unusual has hit Wall Street: Mobile homes are hot; traditional houses are not. The abrupt rise in interest rates has jolted housing stocks, which have all but withered. But not mobile homes. Oakwood Homes, which makes and sells trailers, has outshone the rest of the group: Its shares have climbed from 19 a share in mid-April to 29. What's firing it up?

"Oakwood just keeps on beating analysts' earnings estimates every quarter by a quite a margin," says Barbara Allen of Donaldson, Lufkin & Jenrette Securities. Merrill Lynch analyst Bob Curran agrees: "Once again, quarterly earnings substantially exceeded consensus and our expectations," he says, referring to Oakwood's latest period, when earnings jumped 32%.

"We keep on raising our estimates, and Oakwood just keeps on exceeding them," says Donaldson's Allen, who thinks the company will post even better results next year. "The stock is significantly undervalued," she says, despite its recent advance. Over the near term, Allen sees it hitting the high 30s.

One factor fueling the optimism is Oakwood's acquisition in June of Golden West Homes, a California producer of multisection mobile homes. Allen figures the purchase for stock of Golden West will kick up earnings significantly: She has raised her 1995 earnings projection from \$1.75 a share to \$1.90. Oakwood President and CEO Nicholas St. George says he sees no problems with the estimates.

One Oakwood believer is Fidelity Management & Resources, which has accumulated a 13% stake. Indeed, the mobile-home company boasts of an array of blue-chip investors such as J.P. Morgan, Mellon Bank, and Neuberger & Berman.

INAUGURAL EVENT



INTERNATIONAL MATCH PLAY COMPETITION

September 12-18, 1994

Robert Trent Jones Golf Club
Lake Manassas, Virginia

A TRADITION BEGINS

When the Presidents Cup Match is first played this month, it will have everything one could want from a golf event—except tradition. The same could be said of Robert Trent Jones Golf Club, the site of the inaugural match.

Well, tradition may not be too far behind.

Robert Trent Jones Golf Club, on the shores of Lake Manassas in Gainesville, VA, has been open for play for only three years. But, in that short time, RTJGC has developed a reputation as a tremendous test of golf in an almost unmatched setting.

"We wanted to create a 'destination club,'" said Clay Hamner, the club secretary who was instrumental in its development. "It would be a place where the CEOs and others who had business in Washington could stay, play and entertain. There are other clubs like it (Pine Valley and Augusta National, for example), but none between New Jersey and Georgia."

The story of how Robert Trent Jones Golf Club came to be is evidence of what strong-willed people with an idea, and the means to see it through, can do.

HOW IT CAME TO BE

It begins with the man whose name the club bears, the renowned golf course architect Robert Trent Jones. In the late 1960s Jones spotted a 1,130-acre tract of land in north-eastern Virginia and purchased an option on it with an eye toward building a course.

After exercising the option in 1987, Jones began the search for investors. He first approached Dave Thomas, founder of and spokesman for Wendy's Restaurants, with his desire to build a spectacular club on the property he had seen all those years before. Thomas is a member of Coral Ridge Country Club in Fort Lauderdale, Fla., a club owned by Jones.

Thomas quickly directed Jones to Hamner, a financial consultant and professor at Duke University, who handled some of Thomas's investments. Once they had attracted the necessary funds, which included financial support from the Bishop Trust of Hawaii, construction of the course got underway.

B.P. Russell, president of the club, who had developed a wide array of corporate contacts in business and as chairman of the United States Golf Association Endowment Fund, spearheaded the search for members.

"We were looking for the bright, energetic, well-known brand of CEO," explained Russell, who fit that description when he led Crum and Forster.

"The board was well received," continued Russell. "We were able to attract a group of people who were successful and fun to be around. Good folks."

They also attracted a diverse group. The Board of Governors currently includes the likes of Judy Bell, a prominent Colorado businesswoman and vice president of the USGA; Vernon E. Jordan III, former head of the Urban League and now a Washington lawyer; and Jaime Ortiz-Patino, who is president of Valderrama, the club in Barcelona, Spain that will play host to the 1997 Ryder Cup Match.

Construction of the course was completed in 1990, but it was not opened for play for another year, giving it time to mature.

Work then began on the clubhouse, which opened in 1992.

Once opened, it took little time for Robert Trent Jones G.C. to gain a reputation as a fine test of golf, in part due to the club's willingness to entertain outside tournaments.

"We wanted our course not only to be great for our members," explained Russell, "but also a challenging test for a major golf event."

Last year, the club was the scene of an outing staged in conjunction with the National Sports Awards banquet in Washington. It was then that PGA TOUR Commissioner Tim Finchem and his predecessor, Deane Beman, first played the course.

"They already had been discussing The Presidents Cup Match as a concept," recalled Hamner. "I think this is where the idea gelled."

"The club has everything we were looking for in a site," said Finchem. "Proximity to Washington, a strong membership, a magnificent clubhouse."

Rave reviews, to be sure. But the kind of plaudits the members of Robert Trent Jones Golf Club have grown accustomed to receiving, thanks to the foresight and hard work of its namesake and those around him, who turned the vision he had in the late 1960s into a reality.



The par-four 18th hole requires a long and accurate tee shot.

UNMATCHED LEADERSHIP



Gerald R. Ford, the 38th President of the United States, will be the Honorary Chairman for the inaugural Presidents Cup Match.

President Ford was elected to the U.S. House of Representatives in 1948 and served in Congress for 25 years. He became Vice President on December 6, 1973 and succeeded Richard M. Nixon as President on August 9, 1974, serving until January 20, 1977.

Given his interest in the game of golf, President Ford was a natural and logical choice to be the first Honorary Chairman.

President Ford chairs a Presidents Cup Committee that includes the heads of golf organizations worldwide. The committee members are:

Brian Allan, Chief Executive, PGA Tour of Australia

Michael Bonallack, Secretary, Royal and Ancient Golf Club of St. Andrews, Scotland

Robert Chalmers, Executive Director, PGA of South Africa

Timothy W. Finchem, Commissioner, PGA TOUR

Greg Murphy, President, United States Golf Association

B.P. Russell, President, Robert Trent Jones Golf Club

Gary Schaal, President, PGA of America

Jack Stephens, Chairman, Augusta National Golf Club

Thomas Wulff, President, American Golf Sponsors

Edmond J.H. Yong, Secretary General, Asia-Pacific Golf Confederation

A GLOBAL CHALLENGE

The Presidents Cup Match has been on the PGA TOUR schedule only since March, but the international match play event has been long overdue.

"The great success of the Ryder Cup in the last few years had a lot to do with the increased pressure from our players, the media and golf fans for more match play events. We have responded to the demand with a high-quality event," said PGA TOUR Commissioner Tim Finchem.

"Some of the top international players on our TOUR—David Frost, Greg Norman, Nick Price and others—had expressed a strong desire to have a match play experience," Finchem noted. The Presidents Cup fills that competitive void.

"This brings the top players from the rest of the world into a match-play battle with the U.S. for the first time," Norman said. "We're all really excited about playing in the Presidents Cup."

Hale Irwin, named captain of the United States Team, says he feels the

American side will respond to the challenge.

"The Presidents Cup is going to be a great event," Irwin said. "Not only am I looking forward to being captain, I hope to play my way onto the team."

The first ten places on the 12-man United States Team will be filled based on official money earned from the 1993 Greater Milwaukee Open through this month's NEC World Series of Golf. Irwin will select players to fill the other two spots.

Australia's David Graham, winner of the 1979 PGA Championship and 1981 U.S. Open, will be captain of the International Team. The first ten spots on his team will come from the Sony World Rankings after the NEC World Series of Golf. He then will select the final two members of his squad.

"It's an honor to be selected as the first captain of the International Team for the Presidents Cup," Graham said. "It promises to be a great event on a course that will be terrific for match play competition."

The two captains aren't the only ones excited about the new event. Fred Couples, a mainstay of United States teams in other international competitions in recent years, missed several months earlier this year due to a back injury, but says he hopes to be in top form for the Presidents Cup.

"I think the Presidents Cup is an exciting idea, and I look forward to having a chance to be part of it," Couples said. "I enjoy team

THE PRESIDENTS CUP GIVES THE WORLD'S BEST PLAYERS A CHANCE TO COMPETE HEAD-TO-HEAD FOR THEIR FAVORITE CHARITY



Jeff Maggert, United States



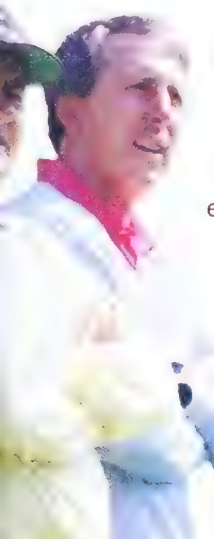
Nick Price, Zimbabwe



Davis Love, United States



Greg Norman, Australia



Captains David Graham and Hale Irwin.



The second hole is a demanding uphill par four with a severely contoured green.

events very much, and I know the U.S. Team will be facing a very strong International Team with many of the world's best players."

"The Presidents Cup is a great opportunity for those of us who cannot qualify to play in the Ryder Cup," says Zimbabwe's Nick Price, the 1993 PGA TOUR Player of the Year. "I'm excited about playing, and I'm sure it will be very closely contested."

The method of determining the U.S. Team means that Irwin likely will have to wait until the conclusion of the NEC World Series of Golf before he knows what his roster will be. Graham, on the other hand, has had a good idea of his lineup for some time. That is because the Sony World Rankings are based on three years of player performance, meaning there is less movement on the list from week to week.

In addition to Frost (South Africa),

Norman (Australia) and Price (Zimbabwe), Graham hopes to draw from the likes of 1993 NEC World Series of Golf winner Fulton Allem and Mark McNulty of South Africa, Vijay Singh of Fiji, Steve Elkington and Craig Parry of Australia and Frank Nobilo of New Zealand when choosing a lineup.

The Presidents Cup offers no prize money. Net revenues will be divided into 26 equal shares for the players and captains of both teams to donate to charities or golf-related projects of their choosing through PGA TOUR Charities, Inc.

Beyond that, the players are competing for personal and national pride.

Chip Beck, a hero of the victorious United States Team at the 1993 Ryder Cup Match, is among the players excited about the possibility.

"I think it is a wonderful thing that we have another international competition of this magnitude," Beck said. "I enjoy

competing against the best and representing my country. Match play is a great equalizer where the will to win is even more important than shotmaking."

Shotmaking will be at a premium at Robert Trent Jones Golf Club, which the famed designer describes as "my masterpiece" among the more than 450 courses he has created in 34 countries.

Bordering Lake Manassas amid the rolling hills of Virginia, an easy drive from Washington, D.C., the "battle-ground" where Captains Graham and Irwin will lead their charges has a link to the history of the region. Military history buffs know the area as the site of the first and second Battles of Bull Run in the Civil War.

No one expects the battle for the Presidents Cup to be as contentious as those earlier confrontations. But, at least in golf's annals, the results should go down in history, too.



INTERNATIONAL MATCH PLAY COMPETITION

September 12-18, 1994

Robert Trent Jones Golf Club
Lake Manassas, Virginia

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The Copley Plaza

Featuring: Mayor Thomas Menino

Philadelphia - October 26, 1994

The Rittenhouse

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EDITED BY AMY DUNKIN

Bali



A DESTINATION CLOSE TO HEAVEN

When my husband and I were contemplating our honeymoon last summer, we developed a case of vacation schizophrenia that pitted our quest for adventure against our desire to recover quietly from our wedding. We decided to try a new hemisphere and, in September, went to Bali, an Indonesian island that accommodates culture vultures as well as idle hedonists. Indonesia is an archipelago made up of more than 13,000 islands, and Bali is a small one sandwiched between Java and Lombok. Unlike most Indonesians, who are Muslim, the Balinese are Hindu. They are also devout: Almost every day, there is some type of religious festival or *barong* dance that outsiders are welcome to attend, sometimes for a small fee.

Though thousands of tourists visit Bali every year, most of it remains a virtually unspoiled paradise. The island is covered year-round with lush

foliage, vivid flowers used as offerings to the gods, and wood or stone statues representing various deities. Bali has volcanoes, beaches, ancient temples, art galleries, and small museums. It has cheap rooms known as *losmen*—usually part of people's houses, they cost just a few dollars a night—and luxury hotels, as well as easily avoided discos and fast-food restaurants.

LOTUS PETALS. You can do a lot in Bali, or you can do nothing at all. We did both. We spent the first half of our trip at Amandari, a magnificent, low-key hotel nestled in rice paddies near Ubud, the island's cultural center. (In the U.S., the number is 800 223-1588.) Rooms start at \$330 per night—high for Bali, but Amandari is the closest thing to heaven I've ever seen. After our 24-hour Singapore Airlines flight, with stopovers in Frankfurt and Singapore (\$1,360 round-trip from New York), a staff member greeted us at the airport in Denpasar



—with hot towels, cold water, and pillows for the hour drive to the hotel.

During our first couple of days, we were jet-lagged: So we just drank tea and Bloody Marys and sat by the hotel's stunning pool, which appears to pour over the hillside. We marveled at the scenery and the amazingly attentive staff:

You could not get up from your chair without someone adjusting your towel. The Amandari amenities were wonderful. Guests stay in high-ceilinged villas—spacious, private and decorated with exquisite carved local wooden furniture. Our villa was at the top of the hill and overlooked green rice paddies and the Ayung Gorge.

A marble bathroom led to a private walled-in courtyard and an extremely enticing sunken bathtub. A big basket of exotic local fruit served our breakfast and was constantly replenished throughout the day. There are no TVs, radios, or clocks in the room

but you won't miss them.

Since this was our honeymoon, we indulged ourselves and got massages. These are not to be missed, particularly the two-hour, \$40 version.



ROOMS AT AMANKILA (LEFT) ARE BUILT ON STILTS ALONG A CLIFF—AND ALL HAVE AN OCEAN VIEW. AT AMANDARI (ABOVE), VILLAS ARE DECORATED WITH LOCAL CARVED-WOOD FURNITURE



UNLIKE MOST INDONESIANS, WHO ARE MUSLIMS, THE BALINESE ARE HINDU—AND DEVOUT: ALMOST EVERY DAY BRINGS A RELIGIOUS FESTIVAL

which takes place in your room and bathtub. While a woman massages you with another fills the outdoor bathtub with lotus petals and water. After you submerge yourself in the tub, one woman massages your face while another scrubs your body with a washcloth.

HUNGRY APES. Sybaritic massages aside, we weren't content with sloths. We paddled down the gorge on a raft and played tennis every day on a hard court surrounded by a forest filled with screaming roosters and barking dogs. A ball boy greeted us each time with two squeaks, a can of new balls, and a pitcher of iced tea. It took us a couple of days to realize he was a terrific player: Once we did, we quickly gave him a hitting with each other and he turns playing with him. Hard as it was to pry ourselves away from Amandari, we spent several days hiking around the area. We visited

Mas, Batubulan, and Batuan, small villages surrounding Ubud that are home to local artisans. Each village specializes in some kind of sculpting, painting, or jewelry-making. If you bargain hard, you can get good deals on wood and stone sculptures, silver jewelry, carved masks, wood panels, and batik wall hangings. We also went with a guide to visit the ancient temples that dot Ubud's mountains. In Ubud itself, we walked through the Monkey Forest. This is no zoo

and is not for the faint-hearted. The monkeys walk around freely, and if you have food in your pockets, they will get it.

After five days in Amandari, we took a three-day jaunt to Yogyakarta, a big city in Java, and then returned for a six-day stay at Amankila, an exquisite hotel on the east coast of Bali run by the same

company that owns Amandari. Amankila starts at \$300 a night. The hotel is built into a steep cliff and has a spectacular view of the Strait of Lombok, as well as a series of three pools that flow into each other and appear to be spilling into the sea. The rooms are as sumptuous as Amandari's, and even though there was no outside bathtub, the bathrooms had settees. Every room had a large terrace with a bed-sized divan. When we arrived, the hotel delivered a bottle of champagne and six white-chocolate-covered truffles to our room. Each night, either two little straw figures or snacks of *lontong*, sweet rice wrapped in banana leaves, were left on our bed.

Amankila has a couple of drawbacks. You have to be in decent shape to navigate the hotel's grounds: Many shallow steps lead to all the rooms, and narrow, steep stone steps go down to the beach. (The hike is worth it, since the

beach is gorgeous and uncrowded.) Also, some of the rooms lack privacy. All the rooms are built on stilts along the cliff, which guarantees each one a view of the ocean. But depending on how high the windows are, a passerby can easily peer into your room. When making reservations, be sure to ask for a secluded

room. We were told that the best were numbers 19 and 23.

One other caveat: The food in Bali is not terrific. The Balinese don't make a big deal over meals, and their diet is mainly simple dishes prepared with grilled vegetables, rice, peanut oil, chicken, and fish. The most common and usually the most delicious were *gado gado*, a spicy, cold, vegetable-and-rice concoction, and *nasi campur*, made of steamed rice, sautéed chicken and pork, and spicy fried string beans and spinach. In Ubud, our favorite restaurants were the Lotus Café and the Café Wayan, a rabbit warren of little table-huts popular with people traveling on a budget (cost: 20,000 rupiah, or roughly \$10 for two). You can also find wonderfully cheap places frequented by the locals. We found one where a meal of *nasi campur* for three people came to \$3.50.

Although the chefs at Amandari and Amankila tried to go beyond the Balinese staples, the food was merely adequate and expensive compared to the restaurants in town. Amankila says the nearby town, Manggis, is not geared to tourists and advises guests to avoid the eateries there. So if you're not adventurous, your meals are limited to the hotel. Amankila's best dish was a lamb-and-pita sandwich served at the restaurant by the beach. Still, the lack of gourmet food was our only disappointment in Bali (and losing weight on vacation isn't so horrible). If we ever take a second honeymoon, we'll return to Bali. *Laura Zinn*

GOING FIRST CLASS

Bimini, Bahamas

SCUBA DIVING MOVES UPSTREAM

To go scuba diving, one needs a \$130 air tank, a \$70 mask, \$80 fins, a \$30 snorkel, a \$180 regulator, a \$300 buoyancy vest, and a \$300 computer you wear to help guard against nitrogen sickness—and that's just to get started. But until recently, cruise operators treated divers like rough-and-ready campers, people who would

Gables, Fla. (800 932-6237) all offer upscale diving experiences at prices ranging from \$1,300 to \$3,000 a week.

The extra attention and amenities make all the difference. On a recent six-day cruise on the Nekton Pilot, I enjoyed five dives a day in the vicinity of Bimini in the Bahamas. The \$1,350-per-person package featured day and

tled. On our trip, only two of the 20 passengers succumbed briefly on the first day at sea (I happened to be one of them).

Living and diving from the same boat all week, you avoid having to lug around equipment, ride wave-tossed skiffs to crowded dive sites, and worry about where to find a good coral reef. And there's no getting gouged for resort-priced meals and drinks, since these are included in the price.

A typical live aboard day goes like this: Rise, eat breakfast, dive. Move the boat, dive. Eat lunch while the boat is

the ocean floor, and warning about currents and other conditions. They failed to warn me about the remoras, though. On one dive, two of these pesky fish—which cling to sharks and boats by means of a dorsal fin that acts like a suction cup—followed me in hot pursuit, hoping to catch a ride.

On our first drop, divers scattered like parachute jumpers as we descended 60 feet and the current carried us past a coral reef. A six-foot nurse shark watched us drift by. That night, my dive buddy Elmer Milz, and I spotted a large octopus that changed colors from purple to grey as it tried to disappear from our lights. In the shallower, murkier water of Gingerbread Shoals the next day, thousands of tiny life forms thrived. The day we returned to water of 10-foot-plus visibility and 130-foot-deep coral-laden cliffs. On our last day, we pulled hand-over-hand down a rope, fighting a five-knot current that stretched us taut like flags on the line, until we reached a sunken barge 100 feet deep that teemed with snappers, angel fish, and other life.

MAYBE THE MOON. Swimming in a giant aquarium is a thrill in itself. The best live aboard ships improve on that experience. On the Nekton boat, a photo lab developed our film. And for an extra fee of \$75 to \$250, the crew offered advanced scuba courses. Sessions in underwater naturalism, photography, and night diving added immeasurably to my appreciation of the underwater world.

I could have used a navigation refresher course. Returning from our last night dive, my buddies and I mistook the full moon for the ship's spotlight. We were half-mile downcurrent when we surfaced. As a chaser skiff dragged us back, I saw phosphorous trail off of Elmer's fins like sparks from a muffle dragging on the highway. On a dive trip, even blunders can be beautiful. *David Greisinger*

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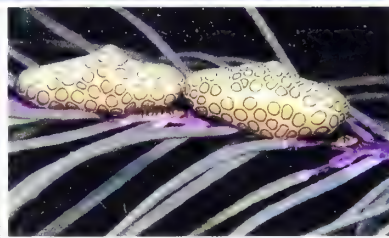


GREISINGER LEAPS OFF THE NEKTON PILOT (ABOVE) TO SAMPLE BIMINI'S EYE-FILLING UNDERSEA LIFE

weather close quarters, little privacy, and dull food just to pursue their sport.

That's changing fast. Today, cruise companies are tailoring their offerings to match the tastes of those who can pay to play the sport. They're building spacious staterooms, cooking better food, conducting more informative dive briefings, and even designing seasick-proof boats in an effort to take their business upstream. Ft. Lauderdale (Fla.) Nekton Diving Cruises (800 899-6753), Aggressor Fleet of Morgan City, La. (800 348-2628), and Peter Hughes Diving of Coral

nighttime dive sites with towering reefs, deep walls of coral, and shipwrecks. The Nekton Pilot, which can carry up to 34 customers, offers staterooms complete with double bed and private bath, a sundeck with Jacuzzi, and delectable cuisine with an island flair. The topper: Nekton's unique twin-hulled design minimizes wave action, so only the most delicate stomachs will be unset-



moving, dive. Dive. Eat dinner while the sun sets. Dive. It's as effortless as falling into the water, which you do a lot. No two dives are alike. And on most cruises, the crew briefs the divers at each new site, telling them what fish and other creatures to watch for, describing the topography of



THE POINT IS SPECIAL, THANKS TO ITS PRISTINE SETTING AND THE PLEASING ABSENCE OF MODERN TECHNOLOGY

new people over the candlelit meals is one of The Point's pleasures.

Then, there is the staff: accommodating yet unobtrusive. Judy Little of New York City recalled returning to the lodge after cross-country skiing last winter. Magically, someone greeted her and her husband, Brian, a partner at leveraged-buyout firm Forstmann Little (now part owner of The Point), at the door with tea and a plate of fresh-baked cookies that they had not even requested.

TENNIS, TOO. You can choose among 11 rooms—each with its own name and character—priced \$775 to \$925 a night. (A 15% service charge and 7% sales tax are additional.) That covers meals and the use of all facilities including three fully stocked bars. (A trip to a nearby golf course is extra, but free tennis is a short walk away.) The Point is half an

hour from the village of Saranac Lake, served by USAir. The busiest months are June through October, but winter weekends fill quickly. For reservations, call 800 255-3530.

The magic of the place is its evocation of what it must have been like to be a guest of the Rockefellers, says Christie McRae Kirmse, a guest from San Francisco. Attention to details—a reconstructed 1929 Hackercraft motorboat, place mats crafted out of tiny twigs, a stuffed fox perched on the mantle—all contribute to that illusion. Once you're there, the hefty tab seems a small price to pay for a trip back to that vanished time. *Amey Stone*

PHOTOGRAPH BY GLEN MOODY

Saranac Lake, New York

CAMPING— THE ROCKEFELLER WAY

How much would you pay to spend your vacation in a log cabin in the wilderness with no phone, nouzzi, or golf course? Does a round \$1,000 a night sound right?

It does if you're a guest at The Point, nestled in the Adirondack Mountains of northern New York. Along with numerous other accommodations, The Point was named the No.1 resort in the U.S. last year by *Zagat Survey*. It has a special place for reasons that are difficult to describe but that have everything to do with the pristine setting and the pleasing absence of modern technology.

The Point sits on a 10-acre peninsula that juts into Upper Saranac Lake, in the 6 million-acre Adirondack State Park. About a 40-minute drive from the Olympic village of Lake Placid, this is the heart of the high-peaks region, dominated by 5,344-foot Mt. Marcy and 4,867-foot Whiteface Mountain.

The remoteness of the area—it still takes six hours

to drive from New York City—drew rich families to build lavish retreats starting in the 1870s. But unlike the "cottages" of Newport, R.I., these lakeside compounds were constructed in rustic style, using logs and local stone. The decor featured handmade twig-style furniture and animal-skin rugs. The "Great Camps" typically included a main lodge, a boathouse, and guest houses. Vanderbilts, Whitneys, and Lewisohns would spend the summer, inviting guests for weeks at a time to enjoy fresh-air rambling by day and formal dining by night.

FABULOUS FALL. The Point is rich with that tradition. Completed in 1933 for William Avery Rockefeller, great-nephew of John D., it was originally called Camp Wonundra and is by far the most lavish of the Great Camps open to the public. Bordered on the north by hundreds of acres of parkland, the scenery is breathtaking year-round but is perhaps most spectacular in early October,

when fall color hits its peak.

The Point offers the joys of summer camp and the appeal of a luxury resort. As at camp, you meet new people, choose from a variety of activities, and get to enjoy nature. Yet the grounds are manicured, the cuisine accomplished, and the rooms charmingly decorated in the Adirondack style. Feather beds, down comforters, and mountain air make guests swear they sleep better here than anywhere else. A huge fireplace in every room is lit for you each night.

During the day, the mood is relaxed and informal. Guests can wander down to the boathouse to take out a canoe or sailboat, set out on a hike with a picnic lunch, or venture onto the trails on

mountain bikes or cross-country skis. Visitors return to the great hall of the main lodge in jeans, T-shirts, and sweaters for an elegant lunch.

At night, The Point gets more dressed up: Guests are encouraged to wear black tie on Wednesdays and Saturdays. Weather permitting, cocktails are served on a large mahogany boat that tours the lake before dinner. Later, in the great hall, there is random seating at the big tables, and diners say meeting

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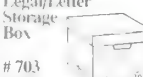


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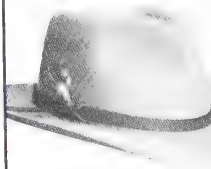
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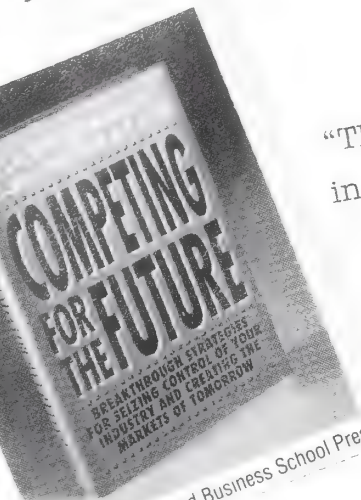
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in the western world."

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the Fifth Discipline



Published by Harvard Business School Press

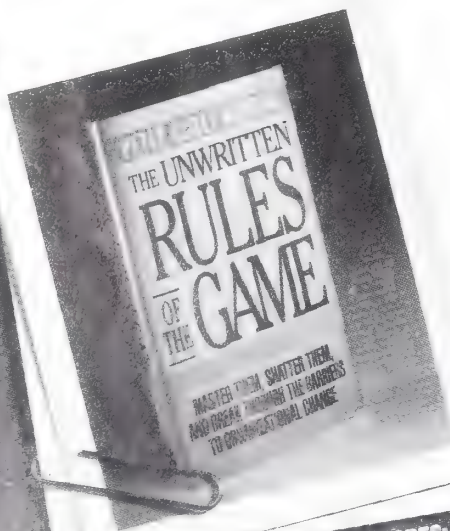
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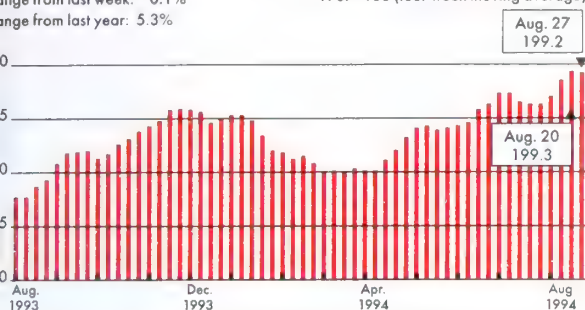
Business McGraw-Hill

Business Week Index

PRODUCTION

Change from last week: -0.1%
Change from last year: 5.3%

1967=100 (four-week moving average)

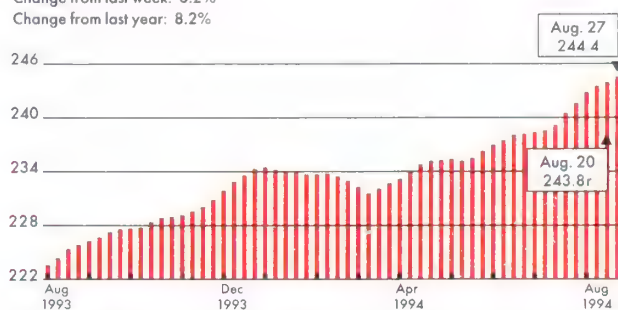


The production index was little changed during the week ended Aug. 27. On a seasonally adjusted basis, auto and truck production fell sharply, and electric power and paper output dropped as well. Steel and coal output along with rail-freight output increased, while crude-oil refining, paperboard, and lumber output were unchanged from the previous week. Before calculation of the four-week moving average, the index dropped to 198.7, from 199.7.

BW production index copyright 1994 by McGraw-Hill Inc.

LEADING

Change from last week: 0.2%
Change from last year: 8.2%



The leading index increased during the week ended Aug. 27. Higher stock prices and faster growth rates for materials prices and the M2 money supply offset the negative effects of higher bond yields. Data for large-business failures and real estate loans were unavailable for the latest week. Before calculation of the four-week moving average, the index stood at 244.9, little changed from the reading of 244.8 in the previous week.

Leading index copyright 1994 by Center for International Business Cycle Research

PRODUCTION INDICATORS

	Latest week	Week ago	% Change year ago
STEEL (9/3) thous. of net tons	1,894	1,858#	3.7
TRUCKS (9/3) units	129,866	115,780r#	37.0
TRUCKS (9/3) units	118,354	115,530r#	31.5
ELECTRIC POWER (9/3) millions of kilowatt-hours	64,790	67,213#	-4.0
CRUDE-OIL REFINING (9/3) thous. of bbl./day	14,259	14,415#	3.4
STEEL (8/27) thous. of net tons	21,010#	20,435	13.8
PAPERBOARD (8/27) thous. of tons	905.0#	886.8	8.1
PAPER (8/27) thous. of tons	826.0#	826.0r	2.0
PIPE (8/27) millions of ft.	477.2#	472.8	8.3
RAIL FREIGHT (8/27) billions of ton-miles	24.6#	24.3	11.3

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., American Paper Institute, WWPAA, SFPA, Association of American Railroads

FOREIGN EXCHANGE

	Latest week	Week ago	Year ago
Japanese Yen (9/7)	99	100	106
German Mark (9/7)	1.55	1.58	1.60
British Pound (9/7)	1.55	1.54	1.55
French Franc (9/7)	5.31	5.41	5.63
Canadian Dollar (9/7)	1.37	1.37	1.32
Swiss Franc (9/7)	1.30	1.33	1.40
Mexican Peso (9/7) ¹	3.398	3.387	3.109

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound expressed in dollars

PRICES

	Latest week	Week ago	% Change year ago
Gold (9/7) \$/troy oz.	389.700	385.750	10.8
Steel Scrap (9/6) #1 heavy, \$/ton	134.50	134.50	19.6
DSTUFFS (9/6) index, 1967=100	213.7	213.2	0.5
Copper (9/3) ¢/lb.	119.1	113.3	31.3
Aluminum (9/3) ¢/lb.	74.0	72.0	37.0
Wheat (9/3) #2 hard, \$/bu.	3.90	3.81	16.1
Iron (9/3) strict low middling 1-1/16 in., ¢/lb.	71.29	70.26	35.4

Sources: London Wednesday final setting, Chicago market, Knight-Ridder Commodity Research, Metals Week, Kansas City market, Memphis market

Low data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment. ¹Western Wood Products Assn. ²Southern Forest Products Assn. ³Free market value NA=Not available r=revised NM=Not meaningful

LEADING INDICATORS

	Latest week	Week ago	% Change year ago
STOCK PRICES (9/2) S&P 500	474.06	467.55	2.6
CORPORATE BOND YIELD, Aaa (9/2)	8.09%	8.13%	22.4
INDUSTRIAL MATERIALS PRICES (9/2)	106.9	106.3	11.9
BUSINESS FAILURES (8/26)	NA	312	NA
REAL ESTATE LOANS (8/24) billions	NA	\$436.5	NA
MONEY SUPPLY, M2 (8/22) billions	\$3,564.0	\$3,560.5	2.1
INITIAL CLAIMS, UNEMPLOYMENT (8/20) thous.	323	325	-2.4

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of large companies), Federal Reserve, Labor Dept. CIBCIR seasonally adjusts data on business failures and real estate loans

MONTHLY ECONOMIC INDICATORS

	Latest month	Month ago	% Change year ago
EMPLOYMENT, CIVILIAN (August) millions	123.2	122.5	2.2
UNEMPLOYMENT RATE, CIVILIAN (August)	6.1%	6.1%	NM
CONSTR. SPENDING (July) annual rate, billions	\$510.5	\$507.5r	9.9
PURCHASING MANAGERS' INDEX (August)	56.2%	57.8%	13.8

Sources: BLS, Census Bureau, National Assn. of Purchasing Management

MONETARY INDICATORS

	Latest week	Week ago	% Change year ago
MONEY SUPPLY, M1 (8/22)	\$1,154.3	\$1,148.4r	5.4
BANKS' BUSINESS LOANS (8/24)	299.7	301.1r	10.2
FREE RESERVES (8/31)	450	518r	-44.9
NONFINANCIAL COMMERCIAL PAPER (8/24)	148.3	150.1	-6.3

Sources: Federal Reserve (in billions, except for free reserves, which are expressed for a two-week period in millions)

MONEY MARKET RATES

	Latest week	Week ago	Year ago
FEDERAL FUNDS (9/6)	4.81%	4.67%	2.99%
PRIME (9/7)	7.75	7.75	6.00
COMMERCIAL PAPER 3-MONTH (9/7)	4.91	4.91	3.13
CERTIFICATES OF DEPOSIT 3-MONTH (9/7)	4.87	4.89	3.11
EURODOLLAR 3-MONTH (9/2)	4.88	4.86	3.11

Sources: Federal Reserve, First Boston

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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

Adolf Coors 76
Aegis Medical Technologies 90
Aetna HealthWays 112
Aetna Life & Casualty 112
Aggressor Fleet 130
Alcatel Alsthom 54
American Express 44
American Greetings 109
American Power Conversion 40
America Online 104
Andersen Consulting 36
Apple Computer 37, 72
Aronson & Fogler 122
Arthur D. Little 36
AT&T 18, 66, 76, 96
Aviation Systems Research 42

B

Banc One 114
Bankers Trust 109
Bank of New York 96
Bear Stearns 114
Bell Atlantic 102
Bell Canada 50
Bell Laboratories 76
Blue Cross & Blue Shield 112
Boeing 44
Bombardier 50
Booz, Allen & Hamilton 35
Boston Chicken 59
Brandes Investment Partners 96
British Petroleum 96
British Telecom 96
Brown 12

C

Campbell Soup 58
Canon 72
Capital Cities/ABC 59
Carlson 32
Castrol 58
Caterpillar 48, 76
CBS 44
Centech 84
Chadwick International 40
Chase-McNulty Group 68
Chiatt/Day 58
Chrysler 30, 32, 40
Cifra 96
CIGNA 112
Coca-Cola 42
Colgate-Palmolive 56
Commercial Realty 68
Compaq 18
CompuServe 104
Confederation Life Insurance 109
Continental Airlines 42
Coopers & Lybrand 36
Credit Life 40
Cuba/USA Venture Enterprises 32

D

Daimler Benz 96
Dean Witter Reynolds 96
Dell Computer 37
Deloitte & Touche 36
Deutsche Bank 96
Dillard Department Stores 122
D.L. Eager Associates 109
Donaldson, Lufkin & Jenrette Securities 122
DuPont 76, 96
Duquesne Power & Light 44

E

Eastman Kodak 18, 44
EDS 36
Electronic Arts 18
Enterprise Oil 96
Eon 68
Ernst & Young 36
Evaluation Systems 90

F

F&M Distributors 43
Fastcast 84
Fidelity Investments 109
Fidelity Management & Resources 122
Finger Lakes Health Systems Agency 12
First Bank System 114
Fletcher Challenge 96
Ford 18, 30, 40, 91
Forstmann Little 131
Foundation Health 112
Fox 44
Fox-Pitt Kelton 114

G

Gabriel Electronics 40
GE 35, 48, 54, 58, 96
Gemini Consulting 36
General Foods 56
Gilbert Tweed Associates 6
Glaxo 76
GM 18, 30, 40, 91
Golden West Homes 122
Goldstar 18

H

Hardinge Brothers 40
Health Care International 6
Healthsource 112
Heidrick & Struggles 36
Heine Securities 114
Heinz (H.J.) 44
Heritage Insurance 58
Hewlett-Packard 40
Hilton Hotels 44
Hitachi 72, 96
Holland & Knight 32
Honeywell 54
Hydro-Québec 50

I

IBM 18, 37, 72, 76, 84
Ica 96
IDD Information Services 104
Incomnet 12
Integrated Resources Technologies 122
Intel Supercomputer Systems 76

J

Japan Tobacco 96
Jennison 109
Johnson & Johnson 32, 44
J.P. Morgan 30, 122
J. Walter Thompson 6

K

Keefe, Bruyette & Woods 114
KeyCorp 40, 114
Kidder Peabody 44
Kimberly-Clark 43
Kodak 56
Komtek 84
Kraft General Foods 59

L

Lamalie Amrop International 36
LASMO 96
Lazard Frères 138
LCI International 66
LDDS 32
Lehman Brothers 24
Lehn & Fink 44
Lever Brothers 56
Life Partners 40
Lynch Machinery 40

M

Manufacturing Sciences 84
Matsushita 18
May Department Stores 122
McCann-Erickson 6
McCaw Cellular 18
McGraw-Hill 28
MCI 32, 66, 76, 102
McKinsey 36
Mellon Bank 122
Mercantile Stores 122
Mercedes-Benz 30
Merck 6, 32
Merrill Lynch 72, 96, 122
Michigan National 114
Microsoft 44, 76
Mitsubishi Bank 48
MMS International 28
Morgan Stanley 96
Motorola 18
MTV 37

N

National City 114
NBC 35
NEC 96
Nektan Diving Cruises 130
Nestlé 96
Neuberger & Berman 122
NISA 109
Northwest Airlines 91
Norwest 114

O

Oakwood Homes 122
Osborne/McGraw-Hill 104
Oscar Gruss & Son 96

P

Pacific Financial Research 59
Paragon Trade Brands 43
Parsons Technology 19
Paul R. Ray 36
Payden & Rygel 109
Pennzoil 58
Peter Hughes Diving 130
PGA Tour 43
Philip Morris 59
Philips Electronics 96
PNC Bank 114
Price Waterhouse 36
Principal Financial Group 91
Procter & Gamble 43, 56
Prodigy 104
Progressive Partners 59
Provident Insurance 109
Prudential Insurance 112
Prudential Securities 44

Q

Quaker State 58

R

Rave Precision 92
Republic Airlines 42
Reuters 104
Revlon 43
Reynolds & Reynolds 109
Royal Bank of Canada 50
Royal Dutch Petroleum 96

S

Saint-Gobain 54
Salomon Brothers 72
Samsung 18

Sanford C. Bernstein 59, 109

Sara Lee 6
Schneider 54
Sudder, Stevens & Clark 96
Seagram 35
Selfridge's 96
S.G. Warburg 96
Shanghai Fangfang 96
Shanghai Petrochemical
Singapore Airlines 128
SNC-Lavalin 50
Sony 54
Southern Progress 35
Southwest Airlines 42
Specialty Oils 58
Sprint 32, 66, 102
Standard Chartered Bank 96
Sterling Drug 44
STET 96
Stone & Webster Management Consultants 36
Sunset Publishing 35

T

Tele-Communications 35
Telebrás 96
TeleCable 35
Televisa 96
Telmex 96
Templeton World Fund
Teneron 19
Tensiodyne 90
Teva Pharmaceutical 96
Texaco 32
The Wall Street Journal
Thinking Machines 76
Time Inc. 35
Time Warner 6, 18, 35
Toshiba 18
Toyota 30
TrueCast 84
Truman Interrel 68

U

Unilever 96
Unisys 72
United Airlines 42
Unlimited Systems 19
USAir 131
U S West 109

V

Valvoline 58
Vision TV 68

W

Warner Bros. 35
Warner-Lambert 91
Weight Watchers 44
Wells Fargo 109
Westinghouse 18, 44
Whirlpool 18
Whydah Partners 6
William M. Mercer 105, 112
Woolworth 91

X

Xerox 76

Y

Yankee Group 66
YPF 96
Yves Saint Laurent 54

Z

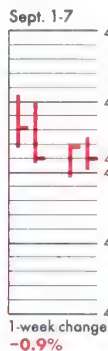
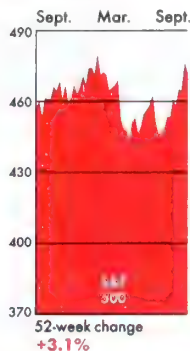
Zagat Survey 131

Investment Figures of the Week

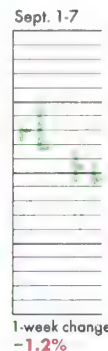
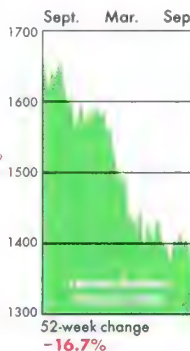
COMMENTARY

Year of inflation reared its ugly head. While economic data showed overall job growth slower than expected, growth among manufacturers kept some bond traders, and yielded on the long bond closed week at 7.56%. The Dow fell much of the week, but perked up on Sept. 6, gaining 13 points on General Motors' report of a new August U.S. car and truck sales report. What the GM report gave, however, the next session took away, and the Dow fell 12.4 points on Sept. 7.

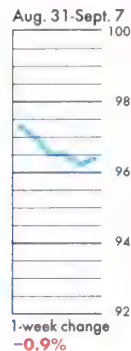
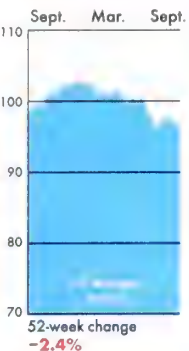
STOCKS



BONDS



THE DOLLAR



MARKET ANALYSIS

STOCKS	Latest	% change Week	52-week
DOW JONES INDUSTRIALS	3886.3	-0.7	8.3
SMALL CAP COMPANIES (S&P MidCap Index)	177.0	-0.8	4.1
SMALL CAP COMPANIES (Russell 2000)	256.8	-0.2	5.7
SMALL CAP COMPANIES (Russell 3000)	270.9	-0.9	2.8

FOREIGN STOCKS	Latest	% change (local currency) Week	52-week
DOW JONES (FINANCIAL TIMES 100)	3203.9	-1.5	5.6
DOW JONES (NIKKEI INDEX)	20,023.8	-2.9	-4.3
DOW JONES (TSE COMPOSITE)	4339.1	-0.2	9.8

FUNDAMENTALS	Latest	Week ago	Year ago
90-DAY TREASURY BILL YIELD	4.65%	4.66%	3.02%
30-YEAR TREASURY BOND YIELD	7.56%	7.45%	5.86%
S&P 500 DIVIDEND YIELD	2.70%	2.67%	2.73%
S&P 500 PRICE/EARNINGS RATIO	18.7	18.9	23.6

TECHNICAL INDICATORS	Latest	Week ago	Reading
S&P 500 26-week moving average	460.7	460.6	Positive
Stocks above 26-week moving average	44.0%	45.0%	Neutral
Speculative sentiment: Put/call ratio	0.40	0.32	Neutral
Insider sentiment: Vickers sell/buy ratio	0.98	0.98	Positive

INDUSTRY GROUPS

1-MONTH LEADERS	% change 1-month	12-month	Strongest stock in group	% change 1-month	12-month	Price
HOTELS AND MOTELS	14.6	9.4	PROMUS	30.6	-17.6	37 3/8
PERSONAL LOANS	13.1	4.0	HOUSEHOLD INTERNATIONAL	15.9	1.3	39 1/8
GOLD MINING	12.2	17.4	ECHO BAY MINES	20.5	23.3	13 1/4
COMMUNICATIONS EQUIPMENT	12.0	4.2	DSC COMMUNICATIONS	23.0	-13.5	28 3/4
DRUGS	10.7	10.3	MERCK	13.8	3.4	34

1-MONTH LAGGARDS	% change 1-month	12-month	Weakest stock in group	% change 1-month	12-month	Price
OIL WELL EQUIPMENT AND SERVICES	-4.6	-17.1	HALLIBURTON	-6.9	-25.1	30 1/4
ELECTRIC COMPANIES	-4.5	-27.2	NIAGARA MOHAWK POWER	-21.2	-48.5	13
OIL AND GAS DRILLING	-3.2	-22.9	ROWAN	-6.3	-21.1	7 1/2
REGIONAL TELEPHONE COMPANIES	-2.7	-9.2	BELL ATLANTIC	-6.0	-14.3	54 5/8
CONGLOMERATES	-2.2	-7.0	ITT	-7.0	-4.9	79 7/8

MUTUAL FUNDS

LEADERS	4-week total return	%
WRIGHT STRATEGIC INVESTMENTS	14.8	
UNITED SERVICES GOLD	14.7	
CRYSTONE AMERICA HARTWELL EMERG. GR. A	13.6	

LAGGARDS	4-week total return	%
WRIGHT EQUIFUND-SPANISH NATL. FID. EQTY.	-4.8	
STEADMAN OCEANOGRAPHIC TECHNOLOGY	-3.2	
RYDEX URSA	-3.1	

LEADERS	52-week total return	%
WRIGHT STRATEGIC INVESTMENTS	72.0	
ORGAN STANLEY INSTL. EMERG. MARKETS	47.1	
AMCO EMERGING MARKETS INSTL.	47.0	

LAGGARDS	52-week total return	%
MONITREND GOLD	-36.1	
STEADMAN OCEANOGRAPHIC TECHNOLOGY	-26.1	
AMERICAN HERITAGE	-25.6	



RELATIVE PORTFOLIOS

Relative Portfolios	Foreign stocks	U.S. stocks	Gold	Money market fund	Treasury bonds
Amounts represent the present value of \$10,000 invested one year ago in each portfolio	\$11,878	\$10,557	\$10,470	\$10,203	\$9,319
Percentages indicate daily total returns	-0.14%	+1.38%	+1.38%	+0.05%	+0.36%

Data on this page are as of market close Wednesday, Sept. 7, 1994, unless otherwise indicated. Industry groups include S&P 500 companies only; performance and share prices are as of market close.

Sept. 6. Mutual fund returns are as of Sept. 2. Relative portfolios are valued as of Sept. 6. A more detailed explanation of this page is available on request. r = revised

A CAPITAL SHORTAGE? CHECK THE MATTRESS

They are the neo-Malthusians of finance—Wall Street economists shouting warnings of the coming capital crisis in the world economy. Instead of hurling jeremiads about impending shortages of food and water in the face of overpopulation, they are raising the specter of a global capital shortage that would cripple economic growth.

On the surface, their argument has a ring of verisimilitude: Economic growth is picking up not only in the U.S., Europe, and Japan but in most of Asia and Latin America. For the first time in recent history, most nations have market economies that are growing fast. Call it synchronized global growth.

This growth, the financial neo-Malthusians say, is putting unprecedented demand on supplies of capital, and a shortage is developing. Lazard Frères partner Felix G. Rohatyn talks about a capital gap of \$1 trillion.

What better proof, they say, than the recent run-up in worldwide long-term interest rates at a time when inflation is low in the U.S. and Europe and declining in Japan? If this capital shortage continues, interest rates could zoom to the point where, in the mid-1990s, economic growth is choked off.

The only problem with the capital crisis thesis is that, in most countries, interest rates today are lower than in the early 1980s. That was long before the Berlin Wall fell, turning communists into capitalists, and Latin American economic planners into free-market advocates. With the international economy in high gear, the capital shortage thesis suggests that rates should be at record levels. They're not.

The reason is supply. While the crisis crowd does a pretty good job of analyzing the growing demands for credit, they neglect the supply side. Take mattress money. A huge supply of capital around the world is tucked away under mattresses, in dollars or gold and silver. Given a decent chance

of not being confiscated either by governments or inflation it emerges and quickly becomes available for investment. China is financing its double-digit growth internally, through domestic savings and the funds of overseas Chinese. It borrows little from the West.

Then there is mobile mattress money, or flight capital. It shows strong signs of returning. Estimates of Argentine flight capital range up to \$40 billion; Mexico \$100 billion; Brazil \$40 billion; Russia \$30 billion.

How much mattress money is there in the world? \$200 billion? \$500 billion? Certainly enough to finance plenty of growth. Throw in billions in savings from the emerging middle classes of Asia and Latin America plus billions from U.S. baby boomers moving into their high-saving forties and the global capital shortage evaporates.

So why are real interest rates rising? In the U.S. it's simply the normal result of economic recovery, reinforced by Federal Reserve moves against inflation. In Europe, bond vigilantes are protesting huge government budget deficits at a time when recovery appears stronger than anticipated. Neither case does a capital shortage play a significant role.

The capital crisis argument does pose one real danger and it is political. Clinton Administration officials are beginning to use the global capital shortage argument to shut the blame for high rates away from domestic policy onto vague international trends that no one can control.

Is an excuse being prepared for a budget-busting, across-the-board, middle-class tax cut for the 1996 election? Is the groundwork being laid for explaining away the higher interest rates that would result from expansionary fiscal policy and deeper budget deficits? Blame it on the international capital shortage! It's a specious argument, and no one should be allowed to get away with it.

A LITTLE HEALTH REFORM IS BETTER THAN NONE

Can Washington salvage anything useful from the ashes of President Clinton's struggle to reform health care? Yes. It can, and it should. The odds against action are lengthening (page 35), but Congress and the Administration still have the chance to take some beneficial steps toward overhauling America's medical industry. Doing so should be their overriding priority in the next six weeks.

Despite the collapse of comprehensive reform, politicians and the public still agree on three things. First, insurance should be available to the sick as well as the healthy and be portable for those who change or lose jobs. Second, the poor should have basic medical coverage. And finally, employers need help to continue their efforts to create a medical market in which efficient, lower-cost care can thrive.

What's needed is Presidential leadership. President Clinton has clung to the elements of his own health plan—par-

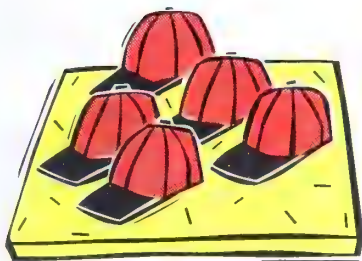
ticularly universal coverage paid for by employers—longer it lost all political momentum. Even now, the White House won't throw its weight behind any lesser reforms. Some in the Administration are urging the President not to compromise, arguing that he can still get comprehensive reform next year.

That would be a mistake of historic proportions. Instead, President Clinton should fight for a solid first step toward his goals. That means reforms to make insurance portable and accessible, even to those with preexisting conditions. It means helping employers who insure their workers, rather than slapping on new taxes and restrictions that will encourage companies to drop coverage. And it requires fairly squarely the costs of guaranteeing coverage for the poor.

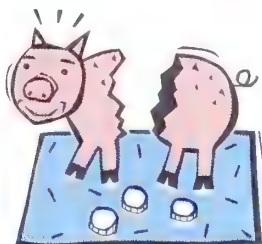
If President Clinton wants to be known as the leader who started health care on the road to recovery, he must act now.

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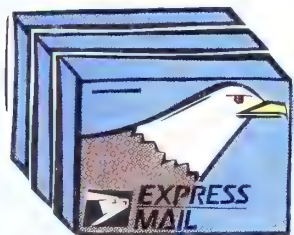
Person has to deliver 50 hats by tomorrow.



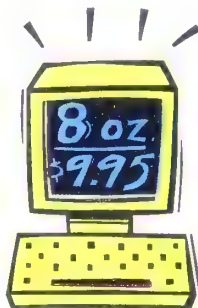
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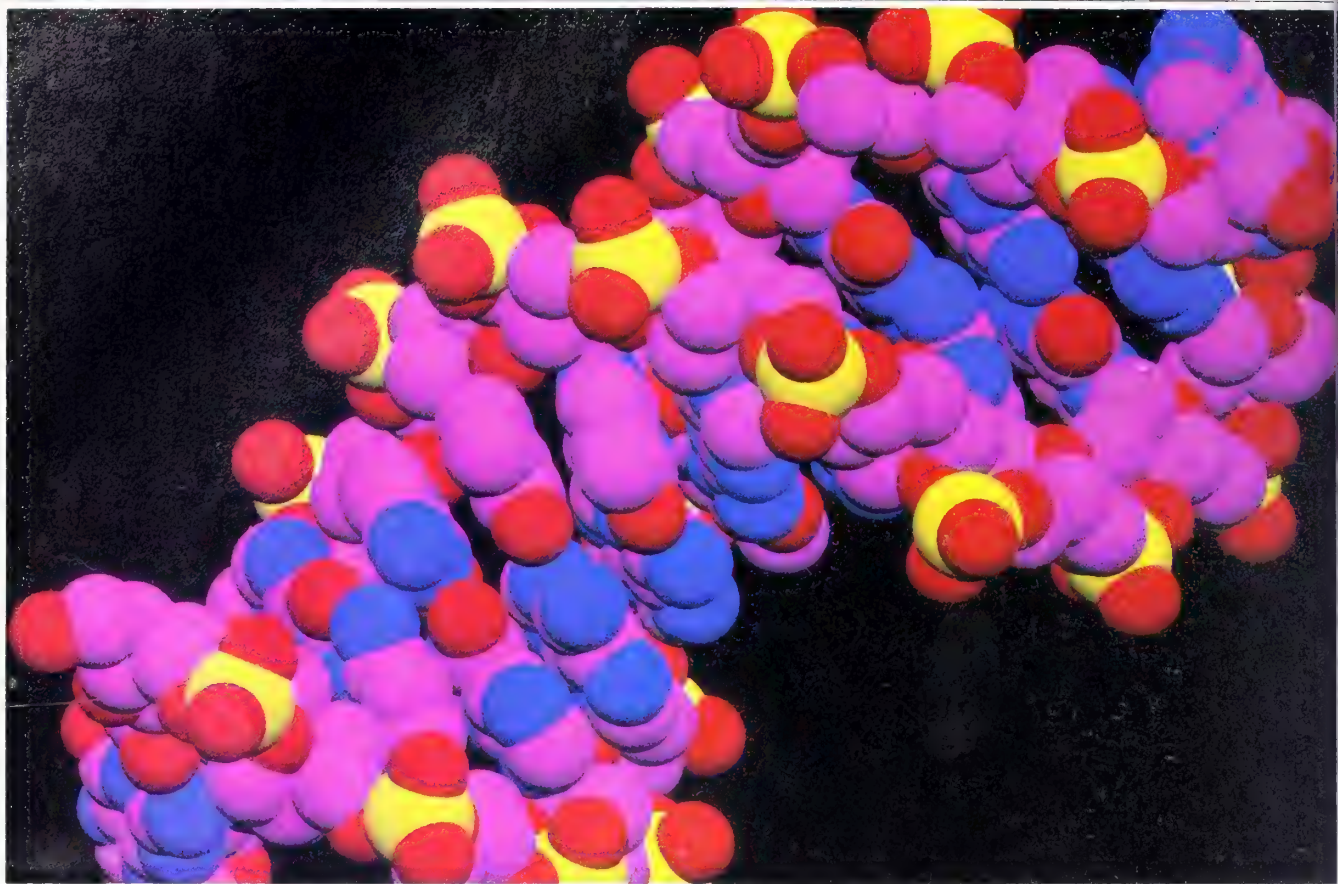
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A DNA MODEL: IT NOW SEEMS BIOTECH DRUGS HAVE NO BETTER ODDS OF SUCCESS AGAINST COMPLICATED DISEASES THAN CONVENTIONAL DRUGS

Cover Story

84 BIOTECH BLUES

After years as America's premier high-tech industry, biotech faces a day of reckoning. Billions in investments have bloated the industry with copycats that are short on capital—and ideas. Yes, a few companies will make it big, but only after a fearsome shakeout causes scores of rivals to disappear—along with most of those billions

88 NOT FOR TIMID SOULS

For the biotech investor, two words of wisdom: Buyer beware

92 PROMISES, PROMISES

Gene therapy is making progress, but it hasn't achieved its potential

54 DOES WALL STREET REALLY GET IT?

It's finally addressing unfairness

55 WHIPPED CREAM FROM ELSIE?

Ailing Borden could lead new owner KKR into green pastures

56 COMMENTARY

Middle-class tax cuts: Bad idea

58 A SHIFT IN THE BASEBALL STRIKE

Why players will lose their edge

60 MACHINE TOOLS ARE CLANKING

U.S. manufacturing fuels a rebound

62 COMMENTARY

The new golden age of productivity

64 WANNA CLONE A MAC?

Apple is finding that not many do

64 THE COMPAQ-INTEL FEUD

The computer maker is irked

66 SURVIVAL OF THE BIGGEST

Consolidation among travel agents

66 RENOVATIONS AT HOLIDAY INN

Will breaking it into pieces work?

68 IN BUSINESS THIS WEEK

White House-cleaning, Disney and NBC, a U.S. cellular net, Imax, paying for GATT, departure at Dell

International Business

76 RUSSIA

As the economy stabilizes, more U.S. investment is flowing in

78 EUROPE

Big Blue is wresting autonomy from country fiefdoms—no easy task

80 INTERNATIONAL OUTLOOK

The Quebec vote is prelude rather than prologue

Economic Analysis

22 ECONOMIC VIEWPOINT

Kuttner: Blasphemy from Blinder?

24 ECONOMIC TRENDS

U.S. employment, Detroit's output, Turkey's economy, rail shipments

49 BUSINESS OUTLOOK

Consumers won't abide higher prices

Government

73 WASHINGTON OUTLOOK

At the Federal Reserve, silence isn't golden anymore—and that makes traders nervous

Top of the News

52 QUIET CRACKDOWN

Clinton is taking a surprisingly tough stance on civil rights—and it's making business wince



0 CHECKBOOK BALANCING ACT: SCOTT AND SIGNEY COOK'S INTUIT MAKES QUICKEN, THE SUCCESSFUL PERSONAL-FINANCE SOFTWARE—BUT MICROSOFT IS THREATENING

6 A SISTERHOOD OF LAWMAKERS Congress' women's caucus has won passage of 30 bills this year

Social Issues

1 LINKING HANDS IN THE CITIES Teamwork with local groups helps make business philanthropy work

People

0 WILL QUICKEN SLOW DOWN? Intuit's industry-leading software for personal finance is attracting rivals

Environment

4 COMMENTARY Why the Cairo conference is a victory for women and the world

Finance

6 CHASE ADVANTAGE? After a radical revamp in its culture, the bank is doing better than the market thinks

9 PRESERVING SACHS'S STREAK Jon Corzine seems well suited to take over from Steve Friedman

0 AFTERSHOCKS FOR INSURERS The California quake hurt them—and now some are heading for the hills

2 INSIDE WALL STREET Will Manor Care spin off its hotels? A rice trader could start to steam Bruno's may protest too much

3 INVESTMENT FIGURES OF THE WEEK



118 GLOBAL FREE-FOR-ALL: CUSTOMER DEMAND FOR IMPROVED SERVICE IS HELPING TO OPEN PHONE MARKETS WORLDWIDE, SETTING OFF A FIERCE STRUGGLE AMONG CARRIERS

Information Processing

17 TECHNOLOGY AND YOU

A new palette of color printers

114 ADOBE'S ACROBAT FLIES AGAIN

Its document-sharing software has been retooled

Special Report

118 A TITANIC TELECOM CONTEST

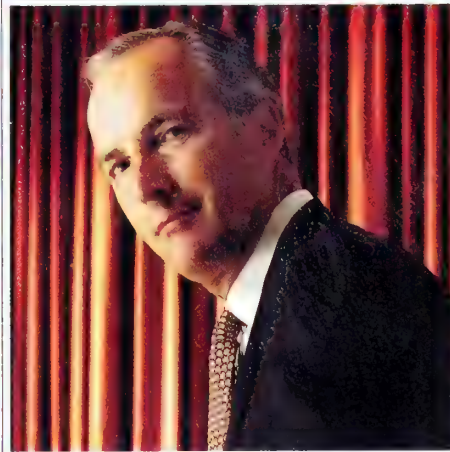
Giant telecommunications companies are redrawing the world map, forging alliances to grab more turf

124 A TELECOM SPARRING MATCH

Britain tests true deregulation



129 GOLDSTAR IS BURNING BRIGHT: ITS ICONOCLASTIC CEO, LEE HUN-JO, HAS TURNED THE SOUTH KOREAN COMPANY UPSIDE DOWN—AND MADE IT A GLOBAL PLAYER



106 A CHASTENED CHASE: TO REVIVE THE HUMBLD BANK, CEO LABRECQUE IS TRANSFORMING ITS CORPORATE CULTURE, INSISTING ON TEAMWORK AND FLEXIBILITY

The Corporation

129 GOLDSTAR STAGES A COMEBACK

Healthy again, the Korean giant is now a global challenger in high tech

132 GLENN JONES'S CABLE UNIVERSE

The quirky visionary is going where no cable mogul has gone before

135 HOW TO ROPE 'EM WITH PLASTIC

Bulls fan? Brown alum? MBNA has a card for you—and a thriving business

Personal Business

146 INVESTING: Energy stocks

SMART MONEY: Foreign bonds

COMPUTERS: Multimedia notebooks

Features

6 UP FRONT

12 READERS REPORT

16 CORRECTIONS & CLARIFICATIONS

18 BOOKS

Phillips: *Arrogant Capital: Washington, Wall Street, and the Frustration of American Politics*

144 DEVELOPMENTS TO WATCH

Brainy microwave oven, repairing weak hearts, 3-D companies, plant growth hormones, GI dress

151 BUSINESS WEEK INDEX

152 INDEX TO COMPANIES

154 EDITORIALS

A rude awakening for biotech
Give Russia trade advice, not aid
Throw the baseball exemption out

Up Front

TALK SHOW

It's a tempting suggestion, but I'm trying to resist it.

—Alan Blinder, Federal Reserve vice-chairman, responding to suggestions that he "shut up"

EDITED BY LARRY LIGHT AND JULIE TILSNER



HANDYMAN'S SPECIAL? *Teddy's digs may need work*

UNREAL ESTATE

A BIT OF CAMELOT —FOR A MEASLY \$7 MIL

So how come the storied Palm Beach estate of the Kennedy clan has been on the block for the past year, with no takers? You'd think the historical value would make it an easy sell. This is the site of both the glorious camaraderie of Camelot and the not-so-glorious William Smith affair, which did current patriarch Teddy Kennedy no political good.

Seems the estate is overpriced at \$7 million and run-down, say local real estate agents. One, Nadine House—

who says she rebuffed Kennedy retainers who asked her to sell it—believes comparable oceanfront mansions fetch just \$4 million. Plus, she says, the home, built in 1923, needs \$4 million in rehab. "It really is almost a teardown," she says. Problems: no central air conditioning, small bedrooms, some without closets, and an elevator in the middle of the living room. These woes were first reported in the *Miami Daily Business Review*.

Ned Monell, who handles the listing for Sotheby's International Realty, denies it is slow to move or overpriced. A family spokesman says grand houses like this take a while to sell. *Peter Valdes-Dapena*

THICK WALLETS

WHO GETS STOCK OPTIONS? DEBATE HEATS UP

Do stock options, those potentially lucrative goodies that companies tuck into pay envelopes, benefit only the big execs—or the lesser lights, too? That's the latest fight swirling around a proposed rule requiring that stock-option grants be charged against company earnings. They aren't now.

Corporate critics claim the proposal, by the rulemaking Financial Accounting Standards Board, will hurt high-tech startups that lack profits to pay cash incentives. Key to the debate is who gets this



boodle: If it's mainly bosses, the rule's foes could lose sympathy at FASB, which will vote soon on the issue. And pres-

DOWNSIZINGS

IBM: HERE'S YOUR HAT, WHAT'S YOUR HURRY?

It doesn't pay to stay. That's the message IBM employees are expected to get soon from on high, say Big Blue insiders. IBM has almost halved its workforce since 1986 through buyouts (mostly) and layoffs. But the enticements to quit or retire have been growing steadily less attractive. Until July, 1993, an IBMer could leave with up to a year's pay; today, it's a max of 26 weeks.

The company's next effort to trim the ranks through voluntary departures, which could come as soon as late September, is likely to be based on making continued service even less appealing. Fears among the rank and file are that early retirement, for those with enough time in,

may jump from age 55 to 60. Another possibility: rejiggering the pension formula to make high-income years count for less. The company declined to comment on its plans.

The reason for the change is that IBM says it may not get the workforce down to



CHEZ IBM: *Emptier hallways*

goal of 215,000 by year-end. Current nose count is 230,000, although cost-cutting moves outside the payroll area are ahead of schedule. *Ira Sag*

MAD AVE.

HEADING 'AMBUSH ADVERTISERS' OFF AT THE PASS

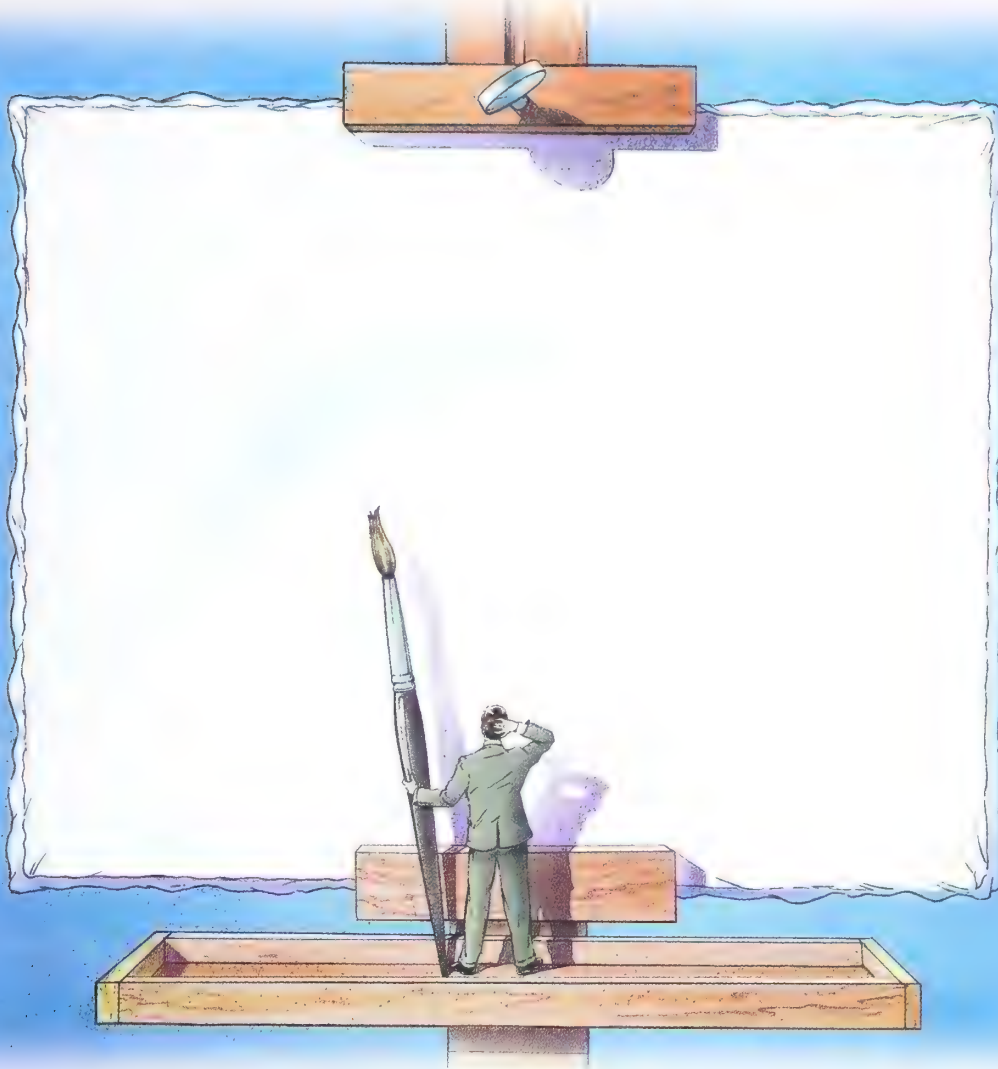
How galling. An advertiser spends millions to be an Olympic sponsor—only to find competitors running spots during the games as if they were, too. In 1992, American Express showed ads set in the French Alps, site of the winter games that year, that

knocked sponsor Visa. And the 1994 Winter Olympics Wendy's International unstaged sponsor McDonald's with its founder, Dave Thomas, performing fantasy feats such as the bobsled run.

This time around, the sponsors aren't going to permit a repeat of this "ambush advertising." In a deal believed to exceed the \$40 million McDonald's paid to be an Olympic sponsor, the hamburger chain has locked up a restaurant spots during NBC's broadcast of the 1996 summer games. Says Pat Schrage, McDonald's chief marketing officer, ambush ads are "a low-class way to gain attention." Coca-Cola and Anheuser-Busch also have locked up exclusive deals with NBC, with other Olympic sponsors expected to follow. *David Greisman*

to—both sides of the debate have unveiled studies to bolster their views.

Rule-backer Senator Carl Levin (D-Mich.) flaunts one by Bethesda (Md.)-based Institutional Shareholder Services showing that 97% of the options in 1992 went to 15 or fewer employees in each of the 5,991 companies it surveyed. And the rule-hating American Electronics Assn. pushes one by ShareData of Sunnyvale, Calif., that has 35% of its 405-company sample giving options to all. The reaction at FASB, says board member Joseph Anania: "These studies have no direct effect on us." □



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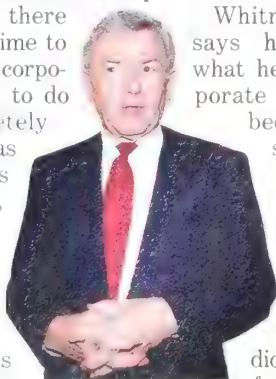
AFTERLIVES

KAY WHITMORE'S NEW SENSE OF MISSION

For everything, there is a season. A time to be CEO of a major corporation, and a time to do something completely different. Ousted as Eastman Kodak's chief in August, 1993, lifelong Mormon Kay Whitmore has gone into missionary work.

Today, he leads the Mormon Mission of Southern England, one of 300 such missions worldwide. Its objective: to lead 170 young Mormon men and women as they try to make converts of Britons. Salary: none.

That's a big difference



NO SALARY: But a terrific boss

from Kodak, where he got some \$1 million a year plus benefits. The difference isn't lost on him. "I've gone from having a big office with a jet at my disposal to a little tiny office where only a few people work," he says.

Whitmore, 62, who says he accomplished what he wanted in Corporate America, has been in England since July. The church approached him with the idea last December, and he decided to make the career shift. "I

didn't want to work for anyone anymore, and I didn't need to," he says.

"This is a good way to transition from being a chief executive. It's better to be totally involved in something rather than sitting around pining away for your old job." □

PRODUCT PEEK

THE NEIGHBORS WILL BURN WITH ENVY

Now you can go to that great putting green in the sky in the bottom of a golf bag. Or to the final roundup snug in a pair of cowboy boots. Cremations are on a steady rise, so the ele-



THE 19th HOLE: Kelco aims to put the fun back in funeral urns

gant but—let's face it—boring urn atop the mantel is giving way to bags, boots, and other more personalized designs. "People understand they don't have to remain with traditional urns," says Dennis McNulty,

sales manager for Kelco Supply, the Minneapolis-based funeral supply company. Kelco started selling designer urns last year and has seen strong demand for them. "We offer urns for all types," says McNulty. The containers each go for around \$550, about the same as for a traditional urn.

A record 20% of the Americans who died last year were cremated, according to the National Funeral Directors Assn. On the Pacific Coast, nearly half of all deaths led to cremation. Reasons for the rise: lower costs, shortage of burial space, and convenience for increasingly transient families.

The aging population suggests a bright future for this grim business. Nearly 2.3 million died last year in the U.S., with 3 million dearly departed expected in 2025. In a crowd like that, a final statement of individuality has an appeal. *Mark Sherman*

DRAWN AND QUARTERED



FWAY PATROL

COMING SOON: SON OF 800

The 800 number, America's wildly popular invitation to call collect, is nearing the saturation point. Some 7.6 million such numbers are available, with 4.1 million now in use. That's up from 3.1 million in mid-1993. If the growth rate continues as expected, 800 will max out in two years or so.

Why the surge? Businesses find it a good way to boost sales and improve customer service. Increasingly, for instance, products come with an 800 number affixed to their labels. New voice-mail technology al-

lows people to do things like check their bank balances, phone without having to dial with an operator. And in 1994, phone companies began offering 800 numbers to households. Result: Several hundred thousand new users who want to let children call home from college or wherever. The

cost isn't daunting, either—monthly with AT&T, plus 1¢ to 25¢ a minute.

What to expect once saturation comes is being chewed over by the Industry Numbering Co.

Numbering Committee, a consortium of all the nation's telephone companies. The likely answer will be to supplement 800, which has been around since 1967, with 300 or 400.

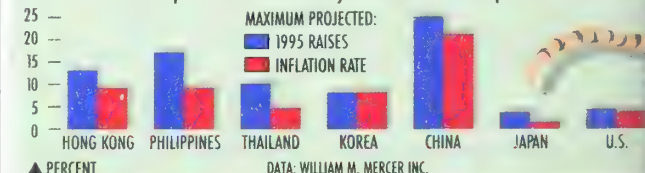


THE BIG PICTURE



WHERE THE RAISES ARE

Salary increases for managers in some of Asia's emerging markets will outpace those of U.S. and Japanese executives, says a new survey. Why? The Asian Tigers fret more over losing management talent to competitors. The survey did not look at specific salaries.



▲ PERCENT

DATA: WILLIAM M. MERCER INC.

FOOTNOTES

Total number of U.S. gambling casinos operating in 1990: **355**; in 1994: **489**

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LYNCH DEFENDS HIS KIDDER REPORT

Your article on my Kidder Peabody report "What Lynch left out" (Finance, Aug. 22) erroneously states that significant questions were left unanswered. In truth, the author of the article knew the answers to his questions because the report itself answers many of them, and the others were answered by me in an interview.

"Where were the auditors?" The report makes clear there were two audits of Joseph Jett's trading desk by Kidder's internal audit staff, neither of which discovered the phantom profits. As the article notes, the report criticizes the Kidder auditors' inexperience and their failure to discover the problem. Contrary to the article's speculation, there were no other audits of Jett's desk during the relevant period, and the author was so informed.

"Where was the cash?" The report explicitly states that one of the problems was Kidder's failure to break out realized profits and unrealized profits in accounting systems, and it recommends the systems be changed to do so.

"Why did 'outside counsel' conduct a 'review' of the government trading desk in October, 1992?" As the writer was told, this was a general review of the entire Fixed Income Div. and was not triggered by any specific event related to Jett's trading desk. The writer was also told that the review's purpose was to identify weaknesses in the supervisory procedures and controls of the division. I did not identify the outside counsel because I believed its identity was irrelevant. The outside counsel was, in fact, Morgan, Lewis & Bockius, one of Kidder's regular outside counsels.

"Did Cerullo's assistant say that Cerullo really knew about Jett's activities?" By citing one individual's recollection that another said that Ed Cerullo (Jett's supervisor) "was aware" of Jett's trading activities, your article implies that Cerullo may have been aware of Jett's phony scheme. Such a conclusion has no basis in evidence. The individual who reportedly said that was not aware of the false

trading scheme at the time and thus could not assert that Cerullo knew about the phantom profits. Rather, he would have indicated nothing more than his belief that Cerullo was aware of what appeared to be legitimate trading by Jett. Indeed, once that individual became suspicious, he was instrumental in exposing the scheme.

"Where was Carpenter?" The report explicitly states the facts: Cerullo reported to Mike Carpenter; Carpenter did not have a background in securities trading; and, rightly or wrongly, Carpenter relied on Cerullo, an experienced trader, and did not personally probe Jett's activities.

In conclusion, the article suggests that, until the questions supposedly identified by the author are answered, the report must be viewed as a "brief for the defense." My only mandate from Kidder was to give my best assessment of what happened and why, based on the facts I found. Not only were the questions answered, but any contention the report is a brief for Kidder management is belied by the report's ultimate conclusion: Jett's phony scheme could only have grown because of lax supervision and misguided judgment on the part of Kidder's management.

Gary G. Lynch
Davis Polk & Wardwell
New York

Editor's note: We feel the points Lynch raises are not errors but matters of interpretation, particularly the adequacy of the report's discussion of whether Carpenter's actions were right or wrong. Lynch was given an opportunity to provide his point of view prior to publication. We dispute the assertion that our reporter was given pertinent information he ignored.

MIKE MILKEN: A HUNG JURY OF PUBLIC OPINION

Re "Mike Milken for Treasury Secretary" (Economic Viewpoint, Sept. 5), I applaud Paul Craig Roberts for providing an overdue encomium for Michael Milken, who was a convenient scapegoat for those who disdain the free-mar-

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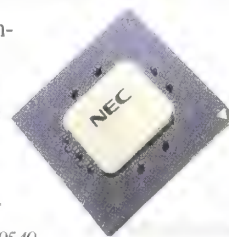
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"This new computer RISC chip technology is really something. It took me one day to complete an assignment that used to take weeks.

Now, if you'll excuse me, I'm off to have dinner with my family."



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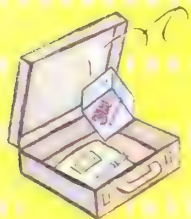


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Readers Report

CORRECTIONS & CLARIFICATIONS

"Mike Milken for Treasury Secretary" (Economic Viewpoint, Sept. 5) erroneously referred to Social Security tax fraud committed by Judge Kimba M. Wood, who withdrew from consideration as Attorney General last year. Although Wood employed an illegal alien in 1986, laws then did not prohibit people from hiring such workers. Wood also insisted she paid appropriate Social Security taxes, and there was no evidence to suggest otherwise.

"A new high-tech dynasty?" (The Corporation, Aug. 15) gave the wrong age for Y.C. Wang, the chairman of Formosa Plastics Group. He is 78.

"Sprint picks up the pace" (Information Processing, Sept. 5) gave the wrong price for the sale by Sprint Corp. of a 20% interest to France Telecom and Deutsche Bundespost Telekom. The price was \$4.2 billion.

"LBO hot-rodders retool" (Finance, Sept. 12) should have said that the \$50 million that Blackstone Group paid to invest in LaSalle Re Ltd. was for a minority stake.

ket system. I am continually appalled at the misconceptions people hold about capitalism. The arguments in favor of it as the only system that supports individual liberties have been made repeatedly by such great minds as Adam Smith, Milton Friedman, and Ayn Rand.

Susan M. Mangiero
Monroe, Conn.

I was shocked to read Roberts' view that the ends justify the means once you reach the billion-dollar level. Milken should be recognized for his brilliant understanding of the use of junk bonds. He also deserved to be jailed for his illegal activities that assured every transaction he engineered using junk bonds would succeed. Milken is the worst kind of villain, one who is so blinded by his own brilliance that he becomes amoral, believing his actions transcend any moral or legal restraints as long as their intention is to prove his ideas are correct.

Sydney J. Hooper
Atlanta

The kind of energy, vision, and spirit Milken has shown in the past is just the right medicine for us to stay competitive in the global society of the future.

Robert K. Fox
Poway, Calif.

Your article on Mike Milken for Treasury Secretary was six months late for the April Fools' edition.

Wendy Bernath Larsen
Boulder, Colo.

Michael Milken has no more business being Treasury Secretary than a fox does guarding a henhouse.

Joel Specter
San Diego

Roberts' article is on the mark, and second the motion.

Henry V. Peltz
Damariscotta Mills, Me.

Nominating Milken for Treasury Secretary is akin to suggesting sainthood for a churchgoing Mafia kingpin.

Michael E. Dunn
Littleton, Colo.

J.C. PENNEY STILL CHURNS OUT CATALOGS

Regarding "Spiegel's book is a real page-turner" (The Corporation, Sept. 12), J.C. Penney has not phased out its "general interest" or any other catalogs. In fact, J.C. Penney is the largest cataloger in America, and one of the largest in the world.

Three "Big Books" are the backbone of this very successful business, the Spring/Summer and the Fall/Winter catalogs and our recently released Christmas book. In total, J.C. Penney publishes about 100 different catalogs each year, including 59 specialty catalogs.

Most catalogers benefited from the withdrawal of Sears, Roebuck & Co. from the general-interest-catalog business in 1993. It would appear that Sears was the reference you were looking for.

W. E. McCarthy
Catalog Communication
J. C. Penney Co.
Dallas

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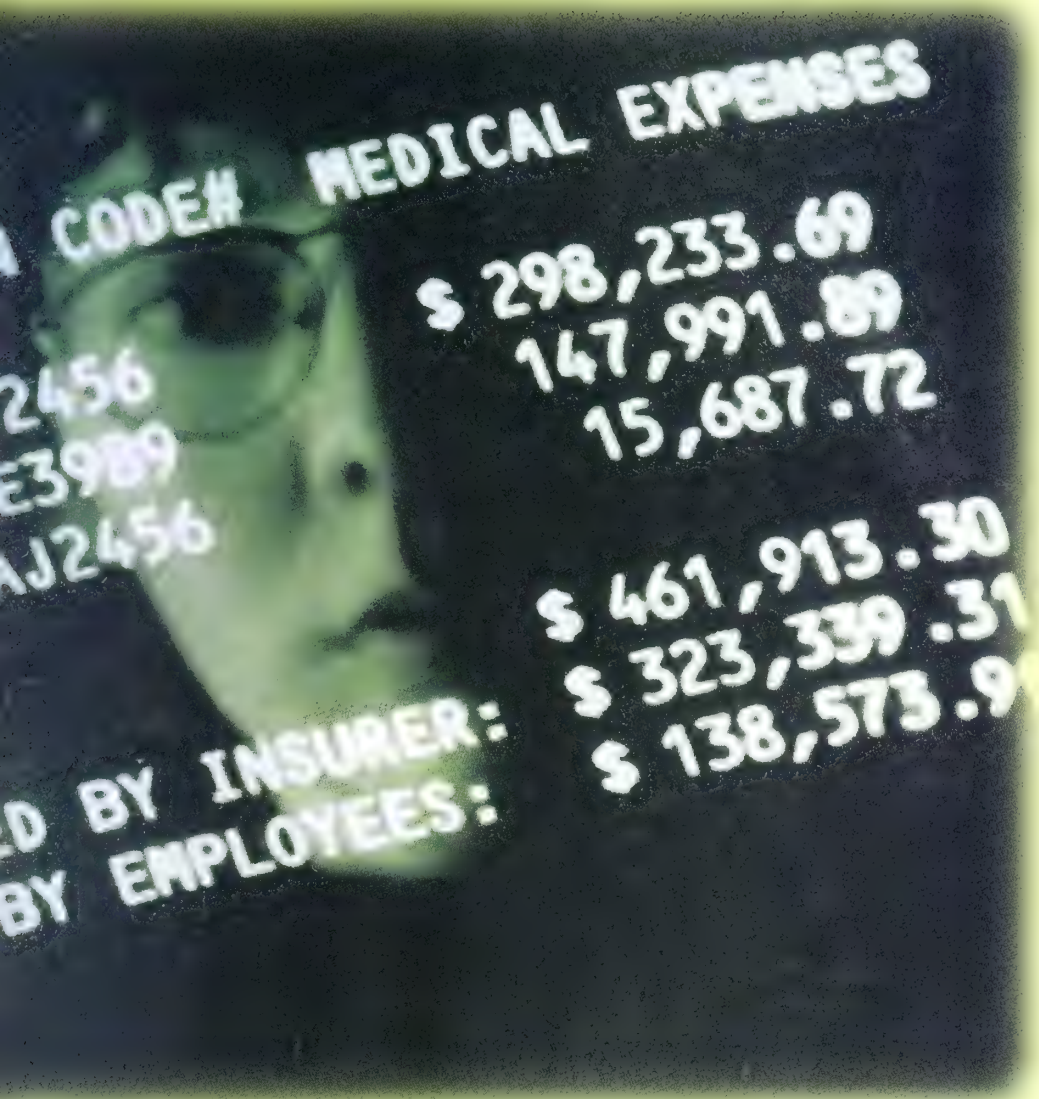
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Rubber gloves and airtight masks won't protect you from the hazards of an inefficient company health plan. Blue Cross of California's Claims Key™ program, however, can help your company steer clear of skyrocketing medical costs.

What is Claims Key? It's a free, in-depth analysis that

will identify how your company could be saving money with our Preferred Provider Organization, or PPO for short. Simply provide us with the claims turned in by your employees over a three-month period. We'll review them and show you, in a side-by-side comparison, just how

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Blue Cross can save you money on medical costs. Which
companies with over 500 employees is something
we've been able to do every single time. ☐ To come in
contact with the people who can help reduce health care
for your company, call your broker or a Blue Cross

Group Sales office. Once you've seen how much money our
free Claims Key service can save your company, we suspect
you'll want to get rid of your current coverage. However, we
do encourage you to **CaliforniaCareSM Health Plans**
dispose of it properly.  **Blue Cross of California**



**SOMEONE DRAWS A LINE AND SAYS,
"THIS IS AS FAR AS YOUR COMPANY CAN GO."**

- (A) You nod and toe the line.**
- (B) You frown and straddle the line.**
- (C) You laugh, jump over the line
and never turn back.**

**If you chose (C),
congratulations. Your company can
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It must be in our genes. It's clearly a part of our State's history. It's our steadfast refusal to accept limitations. Otherwise known as the spirit that has made California the entrepreneurial capital of the world.

Today, that spirit has produced the world's 7th largest economy. And more goods and services than any other state in the nation, with more cutting edge industries and the workplace to let them grow.

That spirit is also behind our state government's responsiveness to business, with everything from

workers' compensation reform, regulatory reform, tax reform and dozens of new partnerships with businesses. And without that spirit, there wouldn't be TeamCalifornia, a statewide alliance of government and business people who (1) don't draw lines; (2) are sponsoring this message; and (3) can help your company go places in California. To learn how TeamCalifornia can help you determine the growth possibilities for your company, or for more information about your company's potential in California, call 1-800-326-2606.



**California. The Climate's Right.
California Trade and Commerce Agency**

BY STEPHEN H. WILDSTROM

WHOLE NEW PALETTE F LOW-COST COLOR

Color printers have been around since the early days of personal computers. But until recently, they only came in two varieties, neither of which offered much for businesspeople. Cheap units were nice for taping up a kid's school report, but didn't produce output good enough for serious business use. High-end color printers were capable of stunning output, but their finicky nature and high

figure prices relegated them to photo-arts shops. Now, improvements in inkjet printing are making quality color printing available for business and home use. The DeskJet 560C (from Hewlett-Packard) and Canon's BJC-600 (Windows only) produce good color on

desktop for under \$500. And the Epson America (800 922-8911) comes the new Epson Stylus Color, at a street price of less than \$600, to set a new standard for low-cost color.

Color can add dramatic impact to a cruciform report, bring drab charts to life, and, above all, give a new dimension to the overhead-projector slides for your presentation. But don't expect to use color on widely distributed reports or memos. Printers remain rare, and commercial duplicating services charge 75¢ or more per page. High-end color printers use various techniques to trans-

fer colored waxes, microscopic particles of plastic, or dyes to paper. The Epson Stylus deposits tiny drops of ink—up to half a million per square inch. The colors are vivid, and the Epson handles subtle changes in hue without producing the distinct bands of color that have long been the hallmark of inexpensive printers. The quality isn't quite up

to the standard of the near-photographic images turned out by \$5,000-plus machines, but the output is astonishing for the price.

The biggest drawback, however, is speed. Like most color inkjets, the Stylus takes about a minute to print a full page of text, compared with about 15 seconds for a LaserJet 4L. If you do much printing, you'll spend a lot of time waiting. Color takes a lot longer, up to 15 minutes for a full-page printout at the top-quality setting.

For all of the Stylus' virtues, pokiness means that it may not be the best choice as your daily workhorse. One alternative would be to put a Stylus on a network, making it available to all members of a work group. Unlike top-of-the-line color units, the Epson can't be connected directly to a Novell Inc. NetWare network, but can be hooked up using a device called a print server.

B&W PDQ. A different sort of compromise is offered by Canon's new \$500 BJC-4000. Although its color quality isn't as good as the Epson unit, the Canon spits out monochrome text pages at a laserlike four pages per minute.

The overwhelming bulk of your printing will continue to be black text on white paper. But used wisely, color can have tremendous impact, and when you need it, you need it bad. The new crop of printers means that you can now get it at a price that nearly every business—and many individuals—can afford. S.W.

PRODUCT
Epson Stylus Color Printer

MAKER
Epson America
Torrance, Calif.

PRICE
\$599 (street price)
\$499 (MSRP)



STRENGTHS
Brilliant color
free from
streaking and
banding

DRAWBACKS
Slow, up to
15 minutes
for best-quality
color pages
plain-paper text
printing
a bit fuzzy

to the standard of the near-photographic images turned out by \$5,000-plus machines, but the output is astonishing for the price.

The Stylus is also easy to install and use. A single disk sets it up for Windows. Software is also included that allows the printer to work with some older DOS programs, although anyone serious about color should probably switch to Windows first. A Mac version is due later this year.

Color doesn't come without compromise, even if the price tag is low. While color output is dazzling, the Epson's black and white printing is no bet-

BULLETIN BOARD

APPLICATIONS

CLEANING UP YOUR WINDOWS

All programs written for Windows can be installed with a click of the mouse. But getting rid of a program you no longer want can pose a challenge, because Windows installations often spread bits of themselves all over your hard drive. UnInstaller from MicroHelp Inc. (800 922-3383) is a handy utility that tracks down the components of unwanted Windows programs to free disk space. When you tell UnInstaller what software to dump, it searches your hard disk and offers a list of files it thinks should be deleted. UnInstall-



er doesn't make deleting a program as easy as on a Macintosh, where all you have to do is drag an icon to the desktop trash can. But it is a valuable addition to the Windows user's tool kit.

GLITCHES

WHAT THE...?!

Anyone with a little computer experience knows that software quality control isn't always what it should be. But the New Grolier Multimedia Encyclopedia, sold as part of the popular Sound Blaster CD-ROM kits, marks a new low. If the computer's video isn't properly configured for the program, it displays the error message: Picture Not In Supported Format. Grolier says the message will be replaced with a less cryptic version in a future release.

Questions? Comments? techandu@mgm.com on Internet or fax (202) 383-2125

ARROGANT CAPITAL: WASHINGTON, WALL STREET, AND THE FRUSTRATION OF AMERICAN POLITICS

By Kevin Phillips

Little, Brown • 231pp • \$22.95

AMERICA THE DOOMED?

Is America in long-term economic and moral decline? Should the government have let the country endure a 1930s-style financial collapse in the late 1980s to teach big, reckless speculators a lesson? Is the proliferation of coffee bars in Washington a sign of corruption and decadence in the nation's capital?

If you answer "yes" to at least two of these questions, you'll enjoy *Arrogant Capital: Washington, Wall Street, and the Frustration of American Politics*. Chances are you already share political analyst Kevin Phillips' view of Washington as a political swamp where a venal elite cashes in even as it lets the nation sink into an economic abyss. The capital has become "a honey pot," he moans. Its "intermingling of public service, loose money, vocational incest, overinflated

salaries, and ethical flexibility verging on corruption has become such a huge gravy train...that the prospect of serious debate is unnerving."

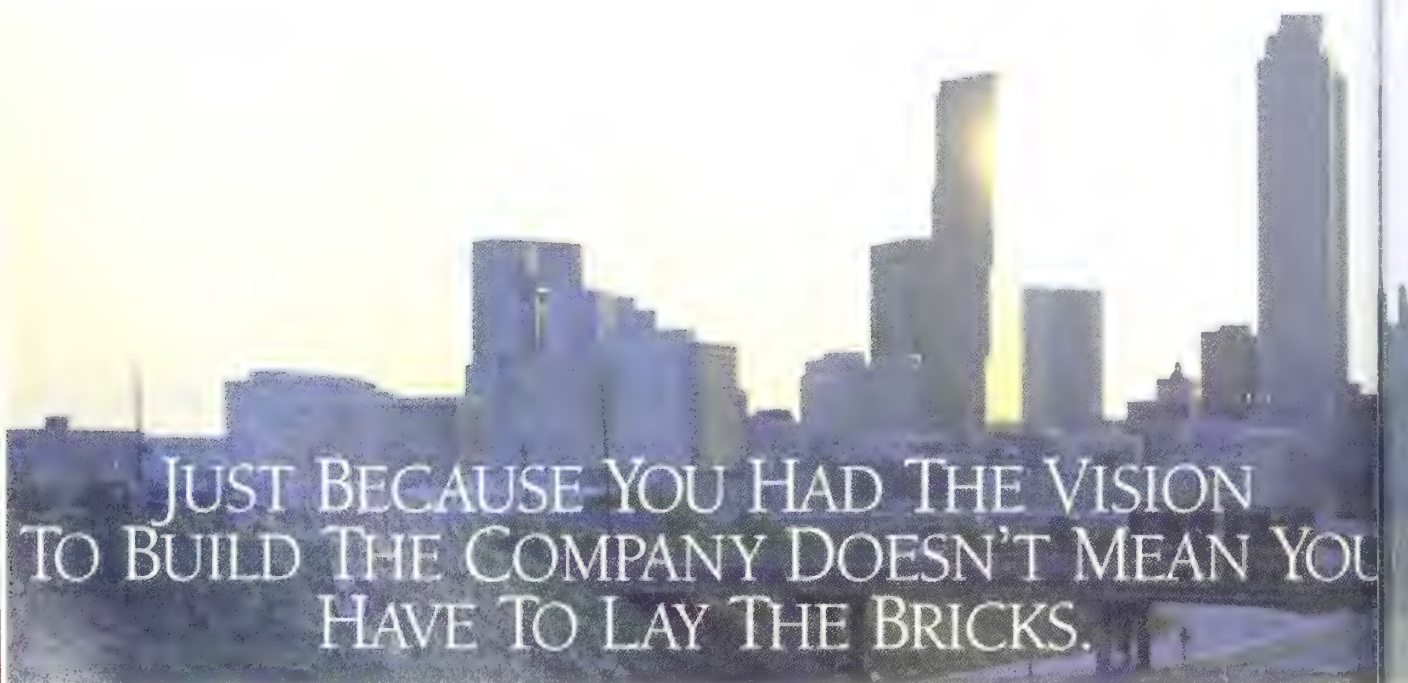
Well, true enough. But if you get past Phillips' anger and examine the facts, he fails to back up his thesis that the U.S. is undergoing the very economic, social, and political changes that sent other superpowers—17th century Spain, 18th century Holland, and 19th century Britain—into decline. This analysis calls to mind Paul Kennedy's *The Rise and Fall of the Great Powers*, which compared U.S. military commitments to the "imperial overstretch" that did in Britain, Spain, and Austria-Hungary. But Phillips discerns different signs that a nation is hitting the skids: a rich, bloated capital city, a shrunken manufacturing base, overly

large and powerful financial industries, the capture of political institutions by special interests, soaring national debt, even tolerance of homosexuality.

Such historic parallels are fascinating, and many of Phillips' observations about Washington's political gridlock, though not new, are on target. But when Phillips ventures beyond political analysis into economics, he goes seriously astray.

He buys into common myths perpetuated by politicians who see advantage in holding up a glass that's always half empty: that the U.S. is exporting jobs, that its factories and high-paying jobs, that what's good for Wall Street is bad for Main Street, that the growth of international trade destroys working-class families, that speculation in exotic financial derivatives has run amok.

Let's get some perspective here. Yes, America's share of the global economy has fallen—but that has been going on since 1950 as nations around the world have grown richer. And while U.S. manufacturing hasn't grown as fast as services have over the past 40 years, Federal Reserve figures show the industrial base has doubled since 1967. Moreover, the Commerce Dept. projects that the U.S.—still the world's top exporter—will



JUST BECAUSE YOU HAD THE VISION
TO BUILD THE COMPANY DOESN'T MEAN YOU
HAVE TO LAY THE BRICKS.

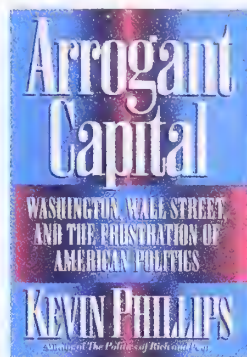
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a record \$493 billion
oods abroad this year.
es, the U.S. experi-
ed a net loss of 2 mil-
manufacturing jobs
the last five years,
ely due to productiv-
gains. But the Labor
t. says most of the
es were in the lowest-
ng industries. And a
al survey by two
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d that the U.S. was
world's most competi-
economy in 1994. No
ot millions have suf-
d because of the
sformation the econo-
has undergone, but

has been the case since America
e up on an agrarian society in the
century. Change can be wrenching.
till, decline? Phillips' contention that
omic policymakers are beholden to
stock and bond markets reflects old
king about financial markets as tools
privileged clique that gains at the
ense of average Americans. In fact,
the explosive growth of mutual
ds—not to mention the millions of
kers with pensions invested in the
kets—Wall Street and Main Street

Phillips is right
about the perils of
political gridlock, but
dead wrong that the
economy is a goner



now intersect. Phillips is equally sim-
plistic in denouncing all derivative activ-
ity as "runaway electronic speculation"
that will trigger a crash if not brought
under tight federal scrutiny.

He is on sounder ground addressing
Washington's political paralysis. When
he decries the unprecedented concentra-
tion of special interests, he fails to
note that many of those interests rep-
resent huge chunks of the public—seniors,
minorities, homeowners, small business-
es. But he's right that there are too

many high-powered gun-
slingers representing nar-
row causes. And he offers
appealing solutions: Move
the capital to other cities
for part of each year, re-
place congressional votes
with national referendums
on key issues, impose leg-
islative term limits, cre-
ate a multiparty system,
and close half the law
schools to reduce the glut
of lawyer-lobbyists. Yet he
dismisses the most obvi-
ous way to diminish influ-
ence-peddling—campaign
finance reform—claiming
"the system is too resist-
ant" to change.

That pessimism underlies the nation's
political problems. Washington is an ar-
rogant capital because it represents a
cynical country. Frustrated citizens
throw up their hands instead of voting
to throw the scoundrels out. Want to
bring Washington to heel? Try some old-
fashioned, grass-roots political activism.
It turns the most arrogant capital deni-
zen into a humble servant.

BY OWEN ULLMANN

*Washington News Editor Ullmann has
covered both economics and politics.*



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6:28 p.m. local time: The new Lufthansa Airbus A340 taking off from New York.

BLASPHEMY FROM BLINDER? NOT REALLY

BY ROBERT KUTTNER



The vice-chairman of the Fed caused a flap by saying the central bank should concern itself with joblessness as well as prices. If anything, however, this supposed inflation dove is too prone to fly with the hawks

I rise in defense of my erstwhile fellow BUSINESS WEEK columnist, Alan S. Blinder, now vice-chairman of the Federal Reserve. Blinder recently had the temerity to suggest that unemployment as well as inflation was of concern, at some times, in some places. From the ensuing uproar, you might have thought he had advocated nationalizing the means of production.

The *New York Times* interpreted Blinder's carefully qualified speech as an "intellectual split" in the Fed's Board of Governors. *Newsweek* columnist Robert J. Samuelson (no relation to the distinguished economist Paul A. Samuelson) pronounced him dangerously "soft on inflation," hence lacking "the moral or intellectual qualities needed to lead the Fed."

But Blinder's actual remarks at the Kansas City Fed's annual colloquium at Jackson Hole, Wyo., reveal no such thing. Blinder did say that "central banks, or more generally macroeconomic policies, do have a role in reducing unemployment as well as...reducing inflation." The Federal Reserve Act itself calls on the Fed to pursue both "maximum employment and stable prices." But this view, sadly, has become controversial.

What Blinder did not say was that he thought the Fed should ease money to fight unemployment in present economic conditions. On the contrary, he declared the economy "extremely close" to its sustainable noninflationary rate of unemployment. As if to underscore the point, Blinder's first vote as vice-chairman last July was to raise rates.

HEARING VOICES? The subject of the Jackson Hole meeting was reduction of unemployment. What Blinder did say was that unemployment is too high elsewhere in the industrial world, notably in Europe. And he observed, correctly, that unemployment has risen most in countries whose central banks were single-mindedly devoted to cutting inflation. He also said that looser monetary policy does have a role at points in the business cycle when unemployment is high.

That thought is hardly controversial. After all, it was Alan Greenspan's Fed that steadily relaxed monetary policy during 1989-1993 to stimulate recovery. Does this make Greenspan dangerously soft on inflation or morally unfit to lead the Federal Reserve? Does it suggest an intellectual split between Greenspan and Greenspan?

I have gently chided Alan Blinder in this space, from the opposite quarter. In my view, there is nothing "natural" about a 6% rate of unemployment, which translates to 8 million unemployed. On this point, Blinder concurs.

"That doesn't mean you can't reduce the unemployment rate below its so-called natural rate," Blinder says. "It only means you can't do so with monetary policy. You have to use microeconomic interventions in labor markets."

Blinder is surely right that we need structural policies to make fuller employment less inflationary. At the high end of the job market, there are spot shortages in some professions and some regions, producing a smidgeon of wage pressure even with an overall jobless rate above 6%. At the low end, millions of unqualified people are effectively out of the labor market. Using monetary policy alone to tighten job markets to the point where unqualified people began looking attractive would bid up wages across the board. **TICKLISH POSITION.** The solution at both ends of the job market is education and training, as well as a less austere Fed. The Clinton Administration grasps that. But given the absence of support in Congress for new training outlays, we are stuck by default with the premise that 6% unemployment is somehow natural and that monetary policy dare not lower it.

Training outlays are indeed indicated, but the Fed should also take its foot off the monetary brake. Blinder, when he was a member of the President's Council of Economic Advisors, seemed to agree. According to the 1991 *Economic Report of the President*, which Blinder helped draft, long-term interest rates, then about 6% (and now close to 8% thanks to the Fed) were already too high. "Clearly, if inflation remains under control, bond yields have some way to fall to come into line with their historical averages."

Inflation remains low. Wages, the most significant source of inflationary pressures, are nearly flat. Some commodity indices are rising slightly, but the core rate of inflation remains minimal. Blinder replies that today, as opposed to last winter, the economy is closer to effective full employment; thus labor-market policy, not looser money, is indicated.

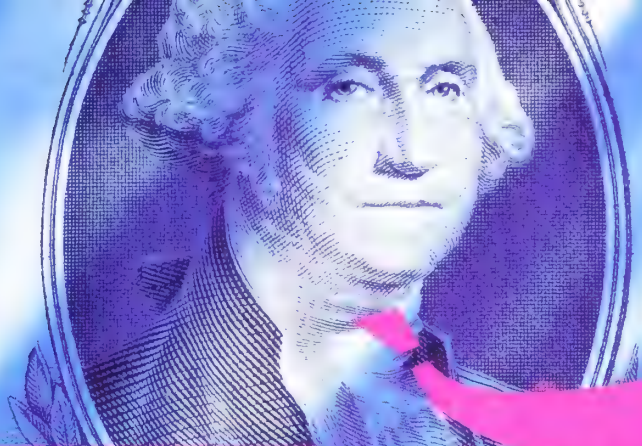
As a recent Clinton appointee to the Fed and a Keynesian, Blinder is, of course, in a delicate position. He is a bit more dovish on fighting unemployment than his colleagues, and somewhat less inclined to panic when he sees a rising commodities index. But his overall view, if anything, is a shade too close to the Greenspan consensus.

Blinder's remarks neither contradicted his earlier views nor provoked a fight with his chairman. "The vice-chairman of the Federal Reserve Board created an incredible controversy by endorsing the Federal Reserve Act," Blinder says. "I'll stand by that endorsement."

ROBERT KUTTNER IS CO-EDITOR OF THE AMERICAN PROSPECT AND AUTHOR OF THE END OF LAISSEZ-FAIRE



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BY GENE KORETZ

WHY U.S. EMPLOYMENT NUMBERS CAN BE HARD TO READ

When the latest employment report indicated that U.S. payroll job growth in August had come in at just 179,000—far below the average 312,000-per-month pace of the previous six months—the financial markets heaved a collective sigh of relief. Fears that tightening labor markets were about to put upward pressure on wages evaporated in the face of this fresh evidence that the Federal Reserve's efforts to put the economy on a slower, more sustainable growth path were succeeding.

Not everyone was surprised by the deceleration in the payroll numbers, however. Anticipating a sharp slowdown

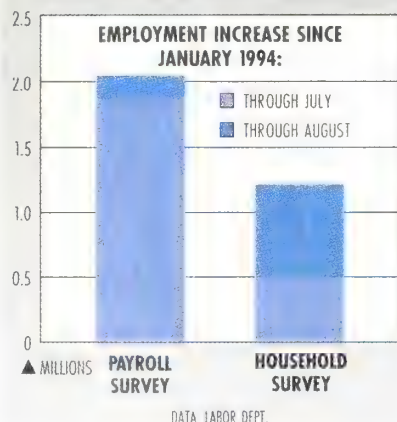
less volatile on a month-to-month basis, however, most experts regard it as more reliable than the household survey, which is based on interviews.

On the other hand, the payroll measure counts jobs and not people as the household measure does, so it can overestimate employment growth when people take multiple jobs. And Labor Dept. statisticians massage it with a "plug" factor, an upward adjustment to account for jobs created by business startups that are missed by the survey.

This adjustment is an educated guess, at best. It can be far too low when the economy is accelerating and too high when it is slowing down. With the plug factor now set at 158,000 jobs assumed to exist before the counting starts, Brusca thinks the payroll data are currently out of whack on the upside. "The survey itself picked up only 21,000 new jobs last month," he says. "Welcome to the ersatz job market."

What of the leap in the household employment measure last month? Brusca notes that seasonal adjustment weighs heavily in August, and lacking historical data, the Labor Dept. is using seasonals from the household survey's previous incarnation. In August, that "iffy" procedure, he says, converted an actual dip in employment of 10,000 into a seasonally adjusted gain of 714,000.

JUST HOW FAST ARE JOBS REALLY GROWING?



in economic growth to a 2%-or-lower pace in the months ahead, economist Robert A. Brusca of Nikko Securities Co. International believes the payroll data have been painting an overly buoyant picture of job growth for some time.

What intrigues Brusca is a stark divergence between the payroll data, based on a survey of business establishments, and the Labor Dept.'s other employment measure, its survey of households. Between January (when the household survey was revamped) and July, the household data showed an employment increase of just 501,000, compared with a nearly 1.9 million increase in payroll jobs. The gap narrowed in August, but remained wide (chart).

Such gaps have occurred in the past, though they tend to disappear over time. Because the payroll survey is based on actual business records and is

DETROIT'S OUTPUT PLANS MAY LACK ECONOMIC PUNCH

With U.S. motor vehicle sales speeding up in August, the Big Three auto makers and the foreign-owned plants that produce cars in North America have announced plans to boost light-truck and car output in the fourth quarter to 3.9 million vehicles—8.3% above the year-earlier level. Some economists figure that should be enough to add a percentage point or two to economic growth in the final three months of the year.

Economist Sam I. Nakagama of Nakagama & Wallace Investment Management Inc. is dubious. He says that some of the largest percentage gains last month were scored by cars with inventories far above the normal 60-day supply. These include Oldsmobile, Buick, Cadillac, and Chrysler's LH series lines. This suggests, he says, that "the pickup may have reflected the use of hefty incentives to get rid of unwanted inventory."

More important, Nakagama notes that "domestic" production projections include vehicles made in Canada and Mexico as

well as the U.S. In fact, the latest plan call for Canadian output by the Big Three to jump 31.7% from year-earlier levels in the fourth quarter, but for U.S. output to rise only 4.3%.

TURKEY'S ECONOMY FACES SOME PAINFUL MUSIC

From 1983 to 1993, Turkey was the shining star of Europe's emerging economies, turning in average growth of better than 5%. No more. Economist Vincenzina Santoro of J.P. Morgan Co. notes that after posting a first-quarter rise of 3.5%, Turkey's real gross domestic product last quarter plunged 11.3% below the year-earlier level, with no revival yet in sight.

Turkey's woes were self-inflicted. For a half-dozen years, the nation managed to foster rapid growth and investment despite high double-digit inflation. But heavy government deficit spending, an excessively easy monetary policy, and soaring trade deficits and foreign debt sparked a financial crisis early this year. In the wake of 7.5% growth in 1993 and accelerating inflation, the nation's international credit ratings were downgraded and the Turkish lira plunged by nearly 60% at last count.

The crisis inspired a shock-therapy austerity package that pushed up government-controlled prices by as much as 125%. Both inflation and interest rates hit triple digits last quarter, and gross investment plummeted 22%. Now, in light of growing social unrest and electoral gains by an anti-Western Islamist political party, some observers are questioning Turkey's ability to continue to swallow the bitter fiscal medicine needed to regain economic health.

RAIL SHIPMENTS: ON TRACK AND PICKING UP STEAM

If the U.S. economy is indeed slowing significantly, that slowdown hasn't yet shown up in one sensitive economic indicator: shipments of goods by rail. Merrill Lynch & Co. transportation analyst Doug Rockel reports that railroad car loadings have accelerated sharply in recent months—running 11% over year-earlier levels in July and 14% in August. The strongest shipment category is metals and products, suggesting that America's capital-spending boom and export growth efforts remain in high gear.

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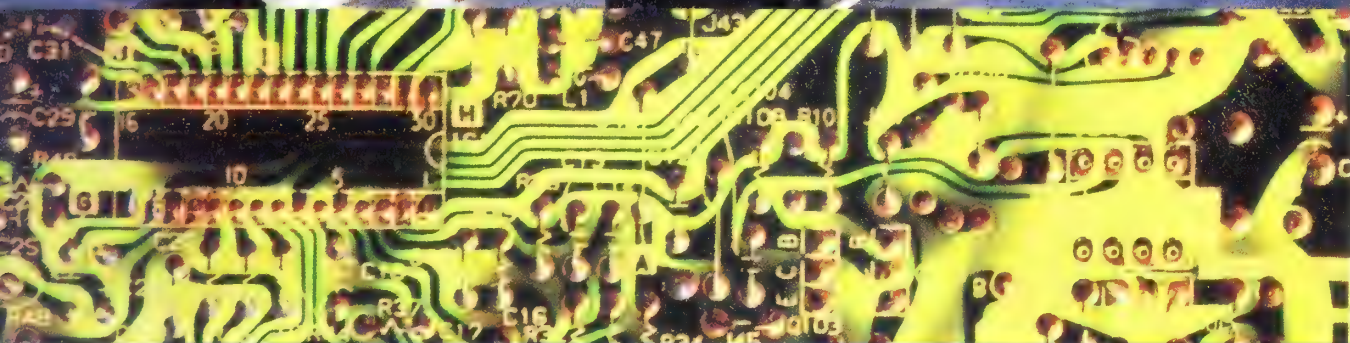


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MICHIGAN



You know Michigan. The state that's seen nearly a half-million new jobs since 1991, outpacing the national average by 30 percent. Where average earnings growth for small and medium sized business in the first quarter of 1994 was 44 percent. A leader in exports to Canada, with exports to Japan up 43 percent, and the fifth largest exporting state. The home of voters who cut property and income taxes this year, to below the national average. Streamliner of state bureaucracy: cuts business taxes, caps unemployment taxes, and holds the line on workers' compensation. A national record-holder, with 29,470 new businesses in 1993. Three of the ten fastest growing U.S. cities are in Michigan.

STATE OF THE FUTURE





John Engler
Governor,
State of Michigan



JOHN ENGLER

Dear Business Week Readers:

With more coastline and sandy beaches than the entire Eastern seaboard, Michigan is defined geographically by the Great Lakes. At the same time, our state's economy is defined by great workers and a great business climate. In fact, we beat the Eastern seaboard and the rest of the nation in that respect as well.

The word is out – Michigan is quickly becoming the best place in America for business to grow and create jobs. We've cut taxes eleven times, slashed permit backlogs and made a commitment to satisfying our customers – taxpayers and businesses who produce quality products and provide quality services.

You'll learn in the following pages that Michigan is no longer part of the Rust Belt but the heart of the nation's new Jobs Belt. Our economy is the engine driving the national economic recovery. Along with Michigan's auto industry, other businesses ranging from plastics to forest products are thriving.

Even though our economy is booming, we're working constantly to keep on improving Michigan's business climate in order to stay ahead of our competition. For example, with overwhelming public approval of sweeping school finance reforms, Michigan businesses and homeowners are now benefiting from the biggest tax cut in state history – more than \$1 billion in net property tax relief.

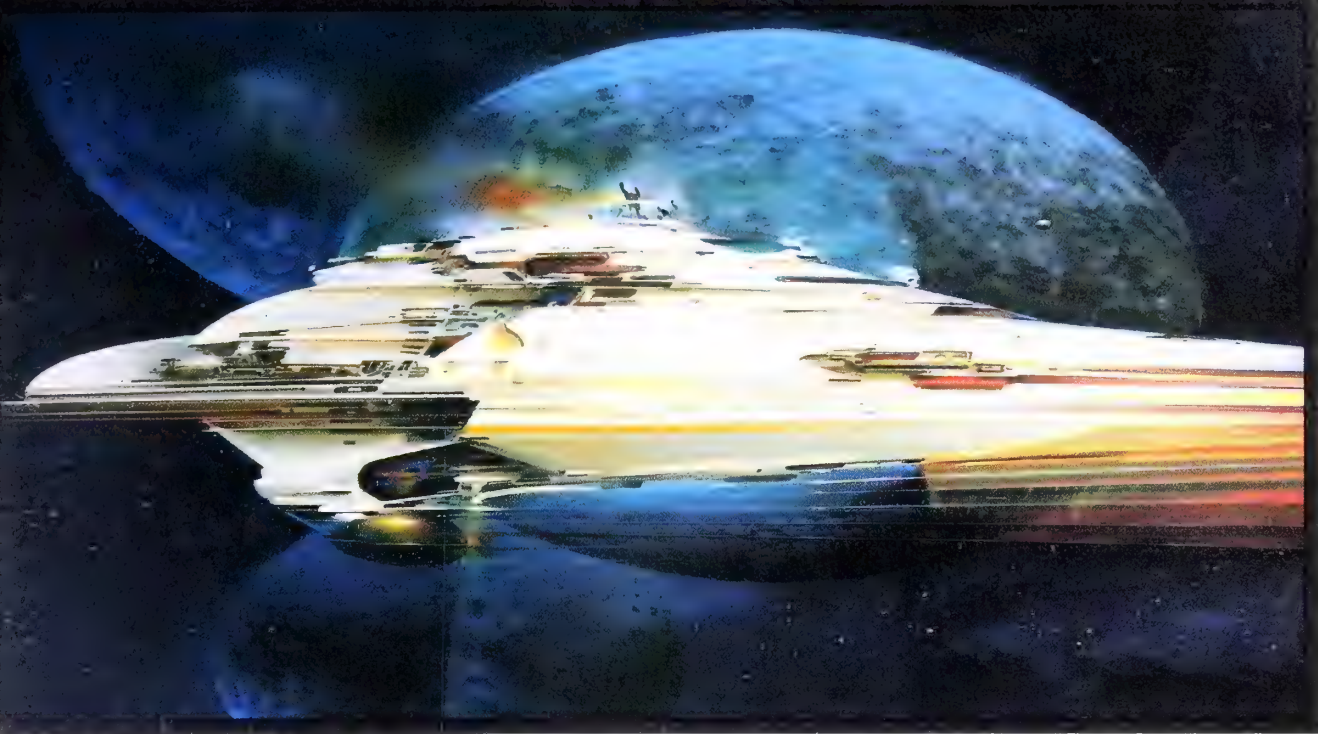
This past summer, we also enacted major reductions in business taxes and eliminated the state tax on most private pensions and annuities. As a result, taxes in Michigan are at the lowest levels in two decades.

I encourage you to learn more about the Michigan success story.

You'll see that we've changed a great deal in recent years. We're open for business and ready to welcome your company. To find out more about making our Great Lakes State home to your business, please call the Michigan Jobs Commission at (517) 373-9808.

Sincerely,

John Engler
Governor



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So You Think You Know Michigan?

Tired old buckle on the Rust Belt. Broken down factories. Cars that don't run. High taxes. Higher unemployment. People headed for jobs in Texas. Last one out turn off the lights.

Sorry, that's yesterday's news. Look at today's headlines:

- > Nearly a half-million new jobs since 1991. More than one third of all jobs created in the U.S. in May 1994 were created in Michigan.
- > Job creation outpacing the national average by 30 percent. The lowest unemployment rate in 20 years.
- > A record 29,470 new businesses incorporated in 1993.
- > Average earnings growth of 44 percent for small and medium sized businesses in the first quarter of 1994.
- > Personal income up 4.4 percent in 1993, 25 percent higher than the national average personal income growth rate of 3.5 percent.
- > Fifth largest exporting state in the nation; leading the nation in exports to Canada; exports to Japan up 43 percent last year.
- > Michigan voters elect to cut property and income taxes this year, to below the national average.
- > State cuts business taxes; eliminates

the state's inheritance tax.

- > The state caps unemployment taxes.
- > Reforms hold the line on workers' compensation rates.
- > State streamlines bureaucracy, creates new customer-friendly attitude.
- > Michigan is home to three of the 10 fastest growing cities in the U.S.

You thought you knew Michigan.

Now you do.

Michigan: The State of the Future

Michigan struggled through the 1980s. There's no other way to describe it. Business management struggled to learn the new ways of global competition and technology. Workers struggled to learn the new skills that pave the way to high paying jobs. Government struggled to learn that you can't build an economy on giveaways, but rather by consistently lowering the overall cost of doing business.

Michigan has emerged in the 1990s stronger than ever, rejuvenated and vibrant, leading the national economic recovery and primed for the 21st Century.

Our auto industry is a winner, no doubt, with the best combinations of quality and value in the world. So are the suppliers to that industry, which have diversified to serve auto makers around the world, as well as a whole range of manufacturers



from appliances to computers. Michigan's well-known furniture makers like Steelcase and Herman Miller are exporting to Mexico and beyond. Food processors like Kellogg Co. and Gerber are taking advantage of the state's extraordinary agricultural prowess to feed the nation. The medical industry is well established, with UpJohn and high-tech medical manufacturers such as Stryker Corp. serving the world.

Businesses large and small are seeing an important difference in Michigan, and its business climate.

"The trends are moving in the right direction," says Terence E. Adderley, president and CEO of Kelly Services, Inc., which is headquartered in Troy, just outside of Detroit. "There's a lot of momentum. The business climate has changed here — there's every reason to be positive about the future," Adderley asserts.

Noel Clark runs a 50-employee office machines company in Lansing, and she says small business owners like where Michigan is going, too. "In the national agenda, we see ourselves as being threatened. In Michigan, however, the business community and especially the small business



Teamwork and automation are keys to Michigan's rejuvenated auto industry, producing cars that are the best value in the world.



Michigan's State Parks are the envy of the nation.

Above: The City of Detroit is a mid-western center for banking, corporate headquarters, and entertainment.

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Amway's world headquarters in Ada, Michigan, putting the final touches on the metal globe sculpture situated among 60 national flags representing Amway's worldwide presence.

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ness community is alive, well, and growing – no endangered species here.

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Why the Growth in Michigan?

Michigan's companies are a big reason for the state's astounding rebound. The lessons of the 1980s were learned well. There's a new attitude of cooperation between managers and workers. The old ideas have died hard, but died they have in the most successful of companies. Quality circles, teamwork, shirtsleeve management, and a new attitude that invites workers to bring their minds as well as their hands to work have helped put Michigan's products at the top of the quality ladder.

The results of the new labor-management attitudes: Work stoppages have trended down throughout the 1980s and into the 1990s. In 1993, only 700 workers out of the state's 4.4 million employees went on strike. More evidence: Six of the 100 best run companies in America are found in

Michigan, including Haworth Inc. of Holland, Herman Miller Inc. of Zeeland, Steelcase Inc. of Grand Rapids and Donnelly Corp. of Holland.

Michigan's government also gets a nod. Under Gov. John Engler, the state put new emphasis on lowering business costs for all job creators, and on making state government more friendly to business.

On the Cost Side:

- > Michigan this year cut its property tax rate by 30 percent, to 9 percent below the national average.
- > Michigan this spring cut its income tax rate from 4.6 percent to 4.4 percent, 30 percent below the average top rate for states with income taxes.
- > Michigan's unemployment insurance rate was capped last year, and reduced for companies with a history of few layoffs.
- > Michigan eliminated its inheritance tax in 1992.
- > The state has cut its timeline for obtaining most permits to 60 days or less, down from one year.
- > The Legislature this summer cut the rate of the Michigan Single Business Tax, the primary tax paid by business, saving employers \$85 million.
- > Michigan's workers' compensation rate increases have been among the lowest of major industrialized states throughout the 1980s.

How is it working? At a recent speech to the Greater Detroit Chamber of Commerce's Mackinac Conference on Mackinac Island, Gov. John Engler noted that Michigan businesses have created 450,000 new jobs since August 1991, and Michigan's unemployment rate of 5.7 percent is the lowest in 20 years.

"In June of 1991, Michigan was dead last among the nation's ten largest states with an unemployment rate over nine percent. Today, with unemployment under six percent, Michigan is Number One," the governor said.

Exporting For Future Growth

Michigan is a huge exporting state, fifth largest in the nation with a 21 percent increase in 1993 to \$25.3 billion – and expectations of even more exports this year, thanks to the North American Free Trade Agreement. NAFTA's lower trade restrictions have Michigan's auto makers and furniture makers predicting hefty increases in sales of finished products to Mexico.

With Canada just a bridge or rail tunnel away, it's no surprise that Michigan is the leading state in exporting to that large market, with \$11.4 billion in goods shipped in 1993. The development of a huge new rail tunnel between Port Huron and Sarnia, Ontario by the international rail concern

CONTINUED...

The Soo Locks allow oceangoing vessels to slip between Lake Superior and Lake Huron at Sault Ste. Marie.

Above: Michigan's modern freight rail system, linked with intermodal truck service, is designed to meet the needs of today's "just-in-time" factories.

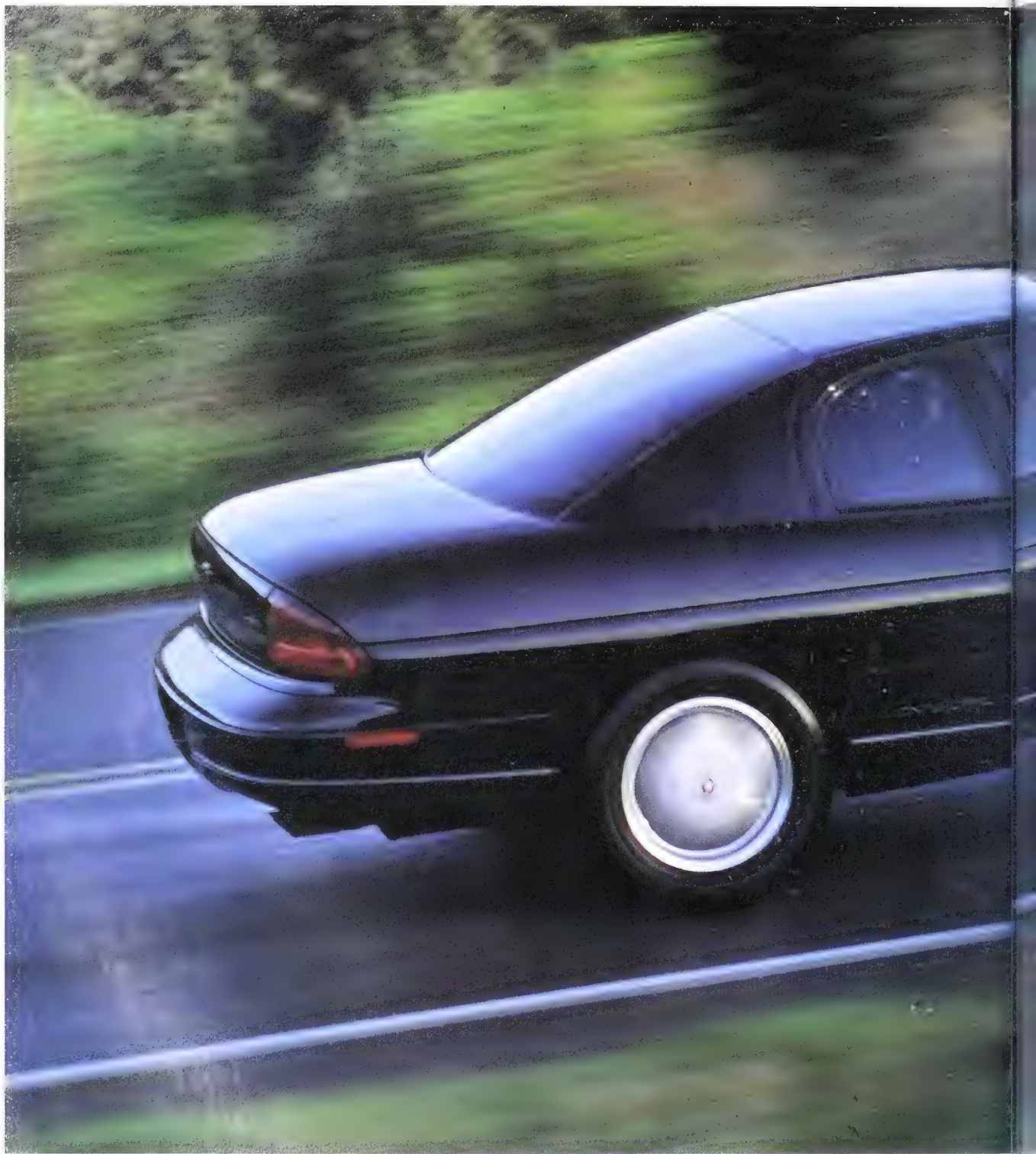


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ceptible shifts of an electronically controlled, 4-speed automatic quickly replace the din of idle conversation. Where what was once a long half-hour commute suddenly seems to be almost too

fleeting. Still, maybe you should think about giving someone else a turn... then again, maybe not.

The New Monte Carlo



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CN-North America will increase the flow of goods between Michigan and Canada.

While Japan is often seen as a competitor with Michigan companies, it was the destination for \$1.06 billion in goods, a 43 percent increase over 1992. Amway Corp., based in Ada, (MI), says nearly a third of its \$5 billion in sales comes from Japan, and the company is one of the most profitable operating in Japan.

Because there is so much foreign commerce in Michigan, the export infrastructure missing in many other states abounds in Michigan. The Michigan International Trade Authority and Michigan Department of Commerce help smooth the way for companies seeking foreign markets. Exporting is a top priority of state government, as leaders recognize it is an important way to grow high-paying jobs.

An Infrastructure for Growth

Michigan provides all the ingredients any company needs for success.

LOCATION AND INFRASTRUCTURE: Nearly half of the United States population and income – and an even larger percentage of Canada's population – is within 500 miles of Michigan. If you have a product that needs to find a retail market, Michigan is in the middle of a lot of customers. Michigan is spending a record \$448 million to

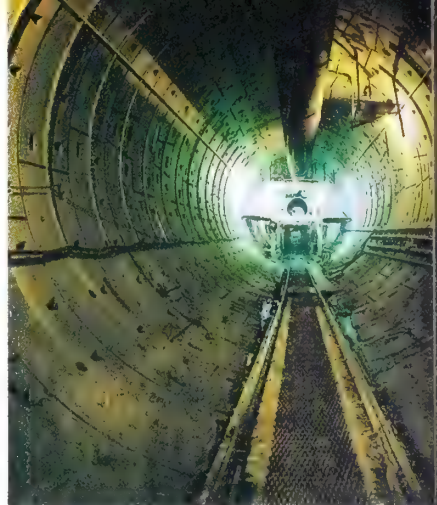
improve major state highways in 1994, part of a total \$860 million in spending from state coffers on road and highway improvements – while maintaining a gasoline tax below the national average.

Michigan is also a leader in developing the telecommunications infrastructure business needs now and tomorrow. More than 300,000 miles of the much anticipated "information highway" is already built in Michigan.

SKILLED LABOR: Nearly 80 percent of Michigan workers have a high school diploma or some college, compared to a national average of about 60 percent. Michigan boasts 15 four-year colleges, led by the nationally known University of Michigan, Michigan State University, Wayne State University and Michigan Technological University, and dozens of well-known private colleges.

Michigan's colleges are increasingly employer-focused. The State has established the campus-driven Michigan Biotechnology Center, Center for Machine Intelligence, the Midwest Manufacturing Technology Center, and other specialized programs that give Michigan graduates hands-on experience before they reach the job market. And Michigan annually graduates more than 5,200 engineers, one of the highest figures for any state.

Community colleges are a major Michigan strength. Apprenticeship training programs



and short-term job training programs to Michigan business and industry are centered in these locally run colleges, providing employers with the training they need.

REASONABLY PRICED POWER: Michigan's major utilities are already meeting and exceeding national Clean Air Act requirements for 1995 and beyond. In surrounding Midwest states, utility rates are heading up as power plants in Illinois, Indiana, Ohio, Wisconsin, Kentucky, and Tennessee are forced to move to low-sulfur coal and add expensive scrubbing equipment. While power users in those states face rate shock, Michigan's rates have stabilized.

FINANCING: Michigan's financial institutions are among the strongest in the nation. Major facilities such as National Bank of Detroit, First of America, Old Kent Bank, Michigan National Bank, Standard Federal Savings & Loan, and dozens of other facilities, have the capacity to meet the capital needs of any business.



*Left and Above:
CN National's new
\$200 million tunnel
between Port Huron,
Michigan and Sarnia,
Ontario will allow
double-stacked rail
cars to move between
the United States
and Canada.*

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a.



b.



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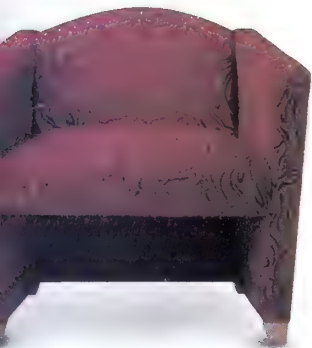
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e.



f.



5.



6.



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A Quick Tour of Michigan

Michigan is a state of rich variety, from the quiet sandy shores of West Michigan to the bustling high-rises of Detroit, the rich dark farm soils of mid-Michigan to the awesome majesty of uncut native white pines in the North.

Each of Michigan's regions is worth an entire book. But here's a quick tour:

West Michigan

Peter Secchia, recently returned from a stint as U.S. Ambassador to Italy and now chairman of Universal Forest Products, Inc. in Grand Rapids, eyes West Michigan from an international perspective.

"I remember giving a speech to the Chamber of Commerce in Zeeland, (MI), a town of 3,000 people and 10,000 jobs, and I was amazed at the international culture of their business. These people know about GATT and NAFTA and international exchange rates."

It's part of a "value added" culture that has grown up in West Michigan, which views itself as an exporter not just abroad, but to other parts of Michigan, the Midwest, and the U.S. as a whole, Secchia says.

"It's no different than Genoa in the 14th Century," says Secchia. "We have our own

little economic region, and when we ship goods outside of it, the accounts receivables return inside of our community. Whether we ship to South Bend or Chicago or Rome and Paris and so forth, we're benefiting from the value we add."

Grand Rapids recently was ranked as having the fifth best environment for business in the nation, according to analysis by the New York-based consulting firm of Moran, Stahl & Boyer, based on attributes including skilled workers, low city/state taxes, competitive wage rates, and pro-business attitudes. The payoff: the city had the third largest percentage gain in manufacturing growth in the nation during 1993, according to figures compiled by the U.S. Bureau of Economic Analysis.

Birgit Klohs is president of the Right Place Program, which helps attract new businesses and fights for better conditions for existing companies. She's also part of the Manufacturers Council, a group of more than 250 local business executives that meets regularly to share ideas on the principles and practices of world class manufacturing. The council recently completed an outline of goals and processes needed to develop a certifiable standard of employability skills, laying the groundwork for developing an internationally competitive workforce for years to come.

"Our goal is to help area industry grow by maintaining the region's position as an



international center for world-class manufacturing," says Klohs.

In Battle Creek, community leadership has formed Battle Creek Unlimited, an economic development group that focuses on keeping local business happy, and on touting the area to foreign manufacturers. Jim Hettinger, president of Battle Creek Unlimited, says 16 Japanese companies including auto parts supplier Nippondenso and candy and cookie-maker Lotte, employ about 4,000 American workers in the Battle Creek area. European manufacturers are on their way, too, led by companies such as Isringhausen, which makes air suspension seats for heavy trucks, and Hotset Corp., servicing the plastic injection molding industry.

"West Michigan traditions of quality education, pride in craftsmanship, a strong work ethic, and an entrepreneurial spirit are foundations of our economic vitality," says Dick DeVos, the young and aggressive president of Amway Corp.



Left: ISI Robotics' Handler IIs and FTTX Transfer Cart move sheet metal parts between stamping presses.

Above: Aerial view of the Amway World Headquarters in Ada, Michigan.

Vos is representative of the involved corporate leadership that is giving back to the region through commitment of time and money. In recent years, that's brought Grand Rapids minor league baseball and basketball and a new museum overlooking the Grand River, and helped revitalize downtown Kalamazoo and Battle Creek with new corporate office facilities for companies like Kellogg and UpJohn.

DeVos has his eye on Amway, too, and has led the company's drive into international markets, while maintaining extensive manufacturing and management operations in Ada, just outside Grand Rapids. "At Amway, we've proven that skilled Michigan people and quality Michigan products can compete and win in the global marketplace," he says.

Ronald B. Johanneson, president and CEO of office equipment maker Haworth, Inc., echoes those sentiments.

Privately owned Haworth, founded by G.W. Haworth in 1948, has seen company sales leap from \$100 million to \$850 million since 1982. Johanneson notes that the company has made major capital investment in high-tech manufacturing equipment, but he gives most of the credit for the company's success to its employees.

"People here have a high degree of loyalty to the company they work for, and also a strong desire to succeed," says Johan-

neson, who has worked in Canada and across the U.S. "There's a feeling that the customer is important."

That dedication has been one reason why Haworth has added one million square feet of new manufacturing capacity in West Michigan in the last six years, and recently selected Ludington, on Lake Michigan, as home to a new plant after a national search. The willingness of state and local governments to provide incentives, particularly job training assistance, also helped.

"Haworth has been very successful developing into an international company by using West Michigan as a base, and we've been successful in good part because of the attitude of the people and the principles they are grounded in," Johanneson says.

Central Michigan

The central part of Michigan enjoys the best of west and east Michigan. With Lansing as its major hub, the region is the site of many auto-related companies. It is also a diversified banking and insurance center (Lansing and nearby Howell are home to three of the state's largest insurers), the focus of state government with the Capitol and related offices in Lansing, and a college-oriented region, with Michigan State University in East Lansing and Central Michigan University in Mount Pleasant serving nearly 60,000 students.

Lansing, the region's largest city, is one of the nation's leading auto-making cities, turning out thousands of fast-selling General Motors mid-sized cars and serving as headquarters to Oldsmobile. Jackson, home to Consumers Power Corp., one of the state's most important utilities, is also a machine tool and auto parts supplier center with a number of Japanese transplant companies.

Midland, in the northern part of the region, is home to Dow Chemical Corp. and its 8,100 managerial and manufacturing employees. J. A. "John" Weymouth, general manager of Dow's Michigan Division and vice president of Dow North America, says "I'm surprised more industry hasn't centered around this area," he says, ticking off the reasons.

"There's energy costs that compete very well with the Gulf Coast. The business climate here is very favorable. And as far as the quality of life goes - it's pretty hard to beat this little town here," says Weymouth, who has overseen operations in 14 states in the last five years.

Weymouth, whose turf includes Dow operations in Traverse City, Ludington, and Bay City, Michigan, is bullish on the state's future. "If you look at things that have been done in recent times, with taxes,



Left: Well-designed work environments such as Haworth's Race® system provides its customers with more than a place to sit and more than \$800 million in sales for Haworth.

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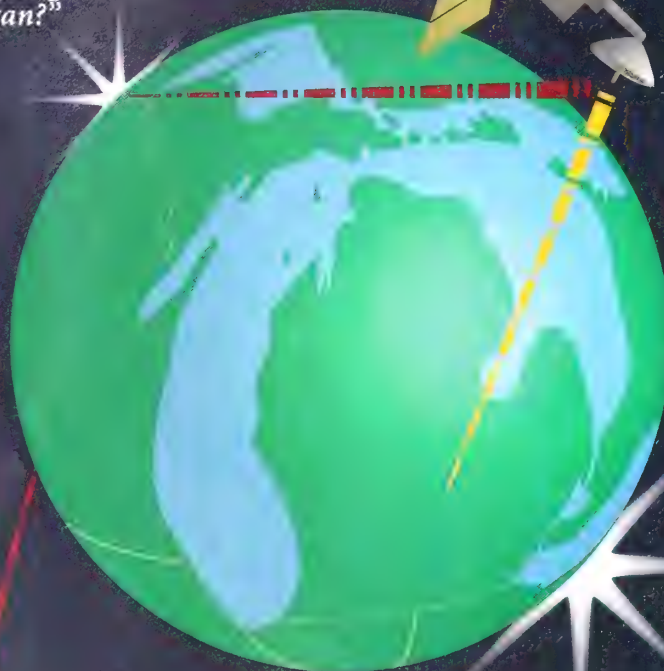
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MICHIGAN



FIRST

workers compensation, changes in the Department of Natural Resources – there's no doubt it has improved."

East Michigan

Eastern Michigan is America's high-tech manufacturing center. From Ann Arbor to Detroit, and north to Flint and Saginaw, manufacturing makes East Michigan work. Many of the nation's leading firms in robotics, computer aided design and manufacturing, automated handling systems, welding, and assembly automation and virtually any modern manufacturing process find East Michigan is the location of choice.

Part of East Michigan's attraction is the auto industry. You know Michigan as home to GM, Ford, and Chrysler. But East Michigan has also seen investment of nearly \$140 million on construction or expansion of technical centers by Japanese automakers like Nissan, Toyota, Mazda and Isuzu.

Why are those companies coming to East Michigan? Because of the critical mass of engineers, designers, skilled trades workers, and knowledgeable, productive line workers who have grown up in a culture of manufacturing that exists in few other places around the world. If you want to build any product – or more importantly, if you want to build the machines to build a product – you can get it done in Michigan, and get it done efficiently.

Eastern Michigan is also home to Ann Arbor and the extraordinary University of Michigan campus there, which has spawned a number of high-tech research and development operations that add to region's desirability for manufacturers. Oakland County, just north of Detroit, has one of the highest per capita incomes of any county in the nation.

Eastern Michigan cannot be overlooked as a location of choice for manufacturers or anyone interested in working with the manufacturing segment of the economy.

Northern Michigan

Northern Michigan, including the Upper Peninsula, is an inspiring mix of forests, lakes, streams, and business. That's why the region is a favorite vacation land for golfers, outdoors enthusiasts, and skiers. Northern Michigan is also an important retirement center, attracting more and more people looking for a quiet and affordable way of life.

But northern Michigan is also home to Michigan's thriving raw materials businesses, with lumbering, mining, and oil and gas industries providing thousands of jobs and billions of payroll dollars.

Northern Michigan is Michigan's playground. It's the site of impressive year-round resorts the equal of any in the nation: The Grand Traverse Resort, the Grand Hotel, Boyne Mountain, Garland.

It's a golf mecca, with courses whose names evoke their beauty and brawn: The Bear, Treetops, The Legend, Crystal Downs. And Michigan's waters hide 50 pound salmon (that's right...50 pound salmon), chrome-sided steelhead, elusive and beautiful brook trout and slab-sided walleyes.

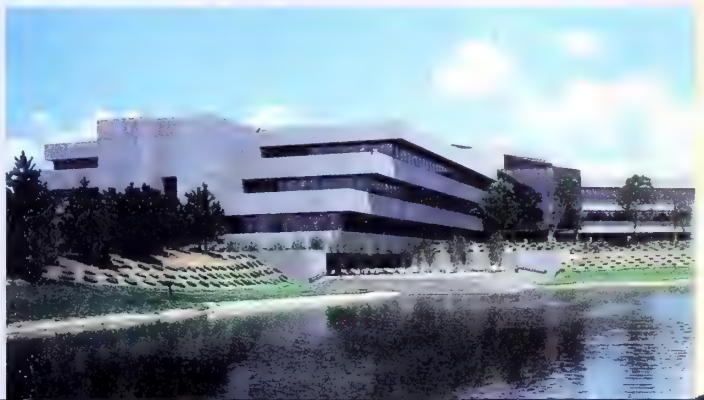
Come See the State of the Future

Michigan is ready for the 21st Century, positioned ideally for the changes that are inevitable. Governments, state and local, are focused on keeping costs down and helping business cut red tape. Major businesses have tightened their belts, improved quality, and are poised for challenges of the next decade.

As Gov. Engler said in a recent speech to business leaders, "In the business world, continuous improvement is not just a concept, it is a daily reality...the same must hold true for government. To compete, we must always change and improve."

That desire for continuous improvement and growth and change, is why Michigan today is the state of the future. If you want to see Michigan, or talk to someone about locating a facility in the state, please call the Michigan Jobs Team at 1-800-MICH JOB or inside Michigan, 517-373-9808.

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VACATIONING IN MICHIGAN

It's not often that a state's motto also serves as a tourism plug. But Michigan's does it well: "If you seek a pleasant peninsula, look about you."

From soaring dunes and untamed wilderness to the perfection of Detroit's museums and symphony, Michigan's attractions shine like beacons to young and old, sophisticated and rustic alike.

And surrounding it all are the Great Lakes, which shape Michigan's two peninsulas and create the longest shoreline of any state except Alaska.

Since 1850, Michigan has been a tourist mecca for the Midwest. The pleasant summers and clean air of Mackinac Island, between Lakes Michigan and Huron, soothed the summers of those suffering from hay fever. Today, the green and white porch of the Grand Hotel provides extraordinary vistas, and the quaint horse drawn carriages that move everything on the island take visitors back to a quieter, slower age.

Chicago visitors have long made West Michigan their own, with lakeside towns such as Petoskey, Charlevoix and South Haven providing a charming tonic to city worries. It's the same today, with the wide beaches and the world's largest freshwater sand dune system lending the Lake Michigan shoreline an air of privacy and retreat that transports sun lovers far from everyday cares.

Grand Rapids also sports Michigan's minor league baseball and basketball teams. But there's nothing minor

league about the city's new museum, which celebrates the region's heritage as center of Dutch culture and furniture making.

In Lansing, the state's newly restored Capitol is a National Historic Landmark. The status was granted because of the Capitol's role as a model for other state capitols, its role in establishing a national architectural symbol of American governance and the quality and extent of the decorative murals, which embellish every wall and ceiling and virtually all of the wood trim throughout the building. The Capitol is a showcase of late 1800s craftsmanship, with sky-high ceilings, decorative wall and ceiling paintings, copper and glass chandeliers and reproduction furniture.

The Detroit area offers visitors a wide variety of sights and events. One favorite is the Henry Ford Museum & Greenfield Village, a uniquely American educational facility created and sustained by the vision of a unique American, Henry Ford. Under his direction, important buildings from America's history were been moved to the 100-acre site, including the Wright Brothers Cycle Shop, Thomas A. Edison's Menlo Park complex, the McGuffey schoolhouse and the slave quarters at the Hermitage. They were carefully reassembled, and give glimpses into the lives of real American heroes.

The Museum also has exhibits showing how the auto has transformed America, and how today's high-tech manufacturing techniques are changing the world of work.

But Detroit also boasts the world-class collections of the Detroit Institute of Arts, the Museum of African-American History, the Detroit Zoo, the Cranbrook Community with its breathtaking 1908 house and gardens, and much more.



Almost every city in Michigan has a treasure to unearth. In Flint, the Alfred P. Sloan Museum features cars from every age, and the Crossroads Village park has an operating steam-driven railroad. Frankenmuth's quaint German streets and restaurants entice hundreds of thousands of visitors each year. Kalamazoo's Aviation History Museum lets visitors see World War II fighters; Ann Arbor is home to the University of Michigan, with its famous quads and quintessential college atmosphere; Jackson's Michigan Space Center holds memorabilia from man's visits out of this world.

Today, as in the 1800s, it is the outdoors that attracts many of Michigan's visitors. The state's golf courses are second to none, with Grand Traverse Resort, Boyne Mountain Shanty Creek, Garland and other resorts winning accolades from golfers nationwide for their beautiful links laid out in pristine surroundings. Michigan this year has hosted a major PGA TOUR, two major LPGA Official Tour Events and two major seniors events, on courses from Grand Rapids to Lansing to Flint to Dearborn.

When the snow flies, the action heats up. While Michigan isn't Colorado, its tall wooded sand dunes have long provided the best skiing in the Midwest, with Boyne Mountain, Highland, Nub's Nobs, Crystal Mountain, and other resorts giving plenty of action for expert and novice. Cross country skiing among Michigan's silent, snow-covered woodlands and rolling hills is an experience that cannot be beat. And if you want winter speed, the long open trails of northern Michigan and the Upper Peninsula provide a snowmobiler's idea of heaven.

Michigan's fishing and hunting draw sports enthusiasts from around the world. Deer hunting is an important part of Michigan life, with some businesses nearly closing down while workers head to the blinds. The state also hosts thousands of duck

and goose hunters each year, bringing dogs and decoys to the natural flyways that line the Great Lakes. Large black bears, fast moving woodcock and cover-busting grouse give hunters more than they can handle.

With water everywhere, it's no surprise the anglers find plenty of action. Saginaw Bay, Lake St. Clair and western Lake Erie are the world's walleye hotspots today, with double digit weights not uncommon. The Great Lakes have become the place to catch salmon, and charter boat captains can outfit everyone from beginner to expert. The "Holy Waters" of the Au Sable, and the quiet riffles of the Pere Marquette and Manistee rivers are among the fabled trout streams of America.

Whether you want to vacation indoors or out, you will find something for fun in Michigan. For nearly 150 years, it's been one of the premier stops for vacationers in Michigan. It is, indeed, two pleasant peninsulas.

*This section was written by David Waymire
of Marketing Resource Group in Lansing, MI.
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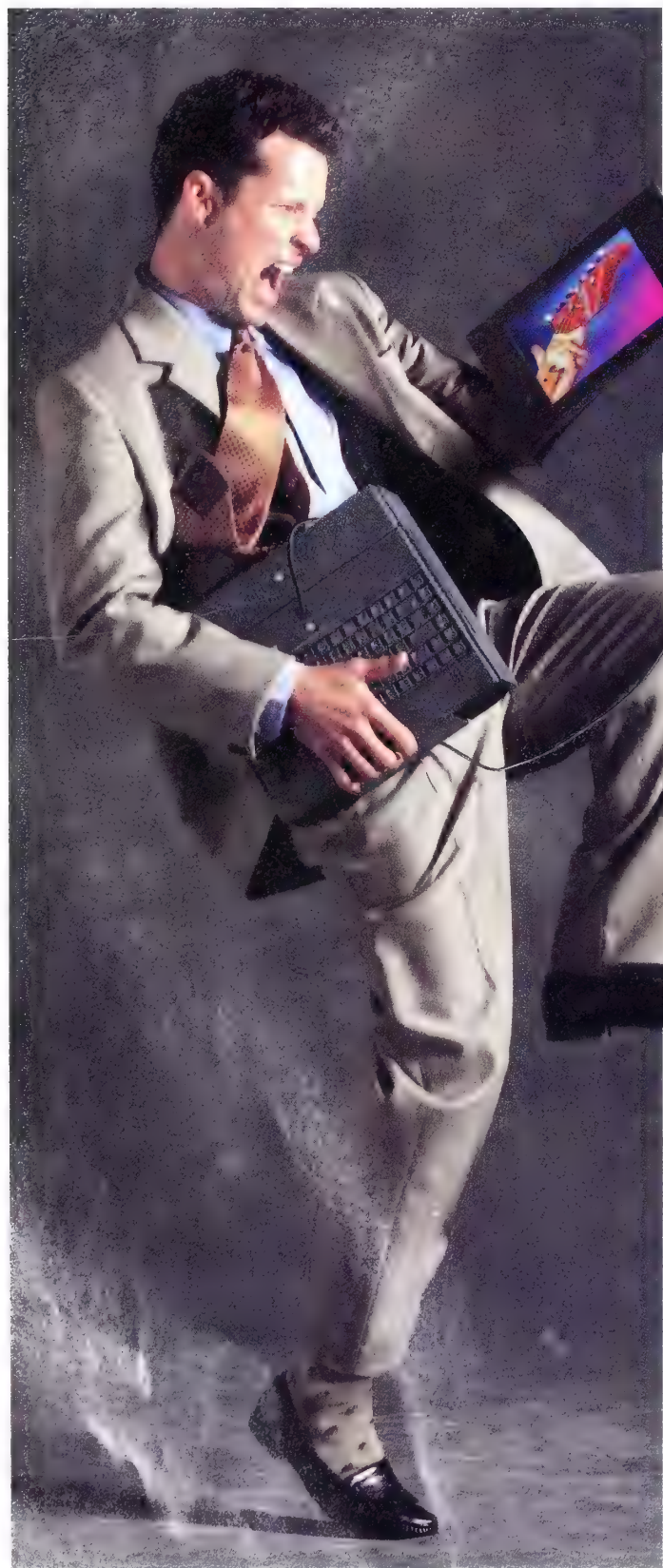
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THE LESSON FOR WALL STREET: CONSUMERS WON'T PUT UP WITH HIGHER PRICES

et's face it: The August producer price index was downright ugly. Its 0.6% jump scared the pants off Wall Street because it seemed to confirm the markets' first inflation fears. Stocks, bonds, and the greenback nose-dived. The core PPI, excluding energy and food, also rose an unexpectedly steep 0.4%, raising fears that August's consumer price index would echo the bad news.

The joke was on those who panicked. The CPI came in as pleasant-looking as ever, with both the total and the core indexes rising a moderate 0.3%. The lesson here is that, despite evidence of budding price pressures early in the distribution chain, consumers are only grudgingly—if at all—accepting any markups on the products they buy.

A key reason why this trend will remain in place is the Federal Reserve's hiking of interest rates. In the wake of rate hikes, the refinancing boom is now a bust, and people with adjustable-rate mortgages must cope with a new drain on their cash flow. As a result, consumers have scaled back their shopping—a slowdown that will carry over to industrial production and job growth.

The cooler pace of demand makes it difficult for retailers to push through higher prices. But for now, the need for heavy markups is muted. Businesses continue to invest heavily in new productivity-enhancing equipment (page 62). And wage gains remain modest. Both trends offset the growth in labor costs, still about three-quarters of total business expenses.

ANY PRICE UPTURN WILL BE GRADUAL Although inflation has probably hit its low point for this business cycle, any upturn will come gradually. Consumer inflation is on track to end the year at about 3%. And given the restraining forces, an acceleration to about 3½% in 1995 seems about as much as can be expected.

The consumer price index showed that price pressures at the retail level are no worse than spotty. Yearly CPI inflation in August stood at only 2.9%, the same as the core index (chart). The core rate has been essentially flat since January.

On closer inspection, even producer prices appeared less frightening. Wholesale prices for energy jumped 0.6%, pushed up by a 6.8% spike in gasoline prices. But

fuel may well be cheaper in coming months, reflecting the \$3-per-barrel drop in crude oil prices during August. Other hikes that will not be repeated: coffee prices, which jumped 12%, and beef, up 6.9%.

The only worrisome sign at the wholesale level was a continued acceleration in the prices of unfinished intermediate goods, such as lumber, industrial chemicals, and paperboard. However, prices of crude materials fell 0.4% in August, suggesting that earlier pressures on materials prices may be starting to ease. Of course, it's not a sure thing that the speedup in intermediate products will even reach finished goods, let alone retail prices.

Even the watchful Fed sees no signs of carrythrough. In its Sept. 14 report on economic activity across the nation, the Fed said that "economic activity continued to expand through the summer," although some "stronger areas saw growth plateau." More significantly, the central bank noted that even with higher industrial materials prices, stiff competition continued to restrain price increases for finished goods.

In fact, producer prices aren't rising as fast as consumer goods prices, so retailers' profit margins are not being squeezed. Even if margins do start to get pinched, picky consumers may force many retailers to eat the loss.

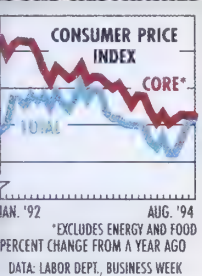
Consumer prices were well-behaved across the board in August. Excluding energy and food, service prices rose 0.4%. But the yearly pace, at 3.5%, remains in a downtrend. Since May, service inflation has held close to a 10-year low. Core goods prices actually fell 0.1% in August, with the yearly rate of rise at 1.5%. Clothing prices dropped 1%, after a 0.4% dip in July. Most likely, stores cut prices to move out summer inventories before the new fall lines arrived.

SHOPPERS SPEND ON SCHOOL STUFF

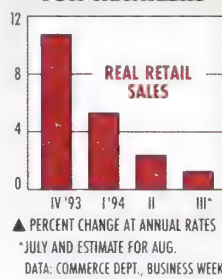
Retailers were able to clear some shelf space in August. Retail sales rose 0.8% after no change in July. Receipts in all the major durable-goods categories rebounded in August, after a dismal July. Sales of nondurable goods continued barely to match the pace of inflation.

Healthy sales increases at clothing and department stores suggest a good back-to-school season. However, that does not negate the slowdown (chart). So far in the

INFLATION STILL LOOKS RESTRAINED



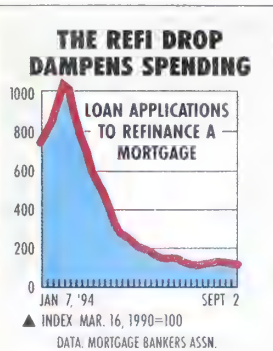
A COOL SUMMER FOR RETAILERS



Business Outlook

third quarter, inflation-adjusted retail sales are up a mere 1.2% at an annual rate.

Retailers who are struggling can blame higher interest rates for that weak showing. Thanks to the Fed, consumers can no longer easily tap into two major sources of cash—mortgage refinancings and credit cards—that propelled spending in 1993 and early 1994. And with those wells dry, shoppers will remain stingy in the second half.



According to the Mortgage Bankers Assn., loan applications to refinance a mortgage have dropped to one-tenth of their pace in February, when fixed mortgage rates hovered just over 7% (chart). In addition, the rate on a one-year Treasury bill, a common basis for adjustable mortgages, has risen 2.1 percentage points in the past year. If homeowners made no extra payments to the principal, that increase would add \$120 to the monthly payments of a \$100,000 adjustable mortgage.

At the same time, costlier finance charges—especially for credit cards tied to banks' prime lending rates—have shoppers thinking twice about using plastic. Witness the \$5.6 billion gain in installment credit in July, half the \$11 billion pace in the four preceding months.

BUSINESSES PLAN TO BUY MORE EQUIPMENT

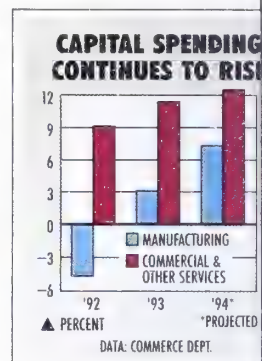
The lack of refis and credit leaves disposable income as the key support to consumer spending. But here again, the Fed's tightening hurts. Real disposable income tracks job growth. And with demand slowing, fewer workers will be hired, suggesting incomes will grow only modestly into 1995.

The Fed must focus primarily on reining in consumers because it will have less influence on other sources of output growth in coming quarters. U.S. exports, for in-

stance, will gather strength from economic growth overseas. And businesses are deciding to buy capital equipment based on what it adds to efficiency rather than on borrowing costs.

Indeed, Corporate America is boosting its outlays for new plants and equipment in the pursuit of productivity, the economy's St. George that may well slay this cycle's inflation dragon. The Commerce Dept.'s summer survey of capital outlays shows that companies are set to increase their budgets by 8.8% in 1994. That's better than the 7.3% rise in 1993, and faster than the 8.3% gain projected in the spring survey.

Both factories and service companies are set to spend more in 1994 than in 1993 (chart). Not surprisingly, manufacturers in such industries as steel, electrical machinery, and plastics that are planning double-digit increases to their capital investments are the same industries where operating rates are above 87%. Manufacturing as a whole will spend 7.3% more this year.



Nonmanufacturers are pumping up their budgets by a hefty 9.5%. The biggest increase will be the 12.5% commercial and other services, which includes wholesale and retail trade, finance, business services, and communications. Already, second-quarter spending by retailers was 19.3% above a year ago, and finance budgets were 15.7% bigger.

All this investment will go toward improving the efficiency of service companies, where productivity gains have lagged the advances made at factories. Clearly, companies must hold down their unit labor costs to keep the price indexes appealing to the wary eyes of inflation-fearing investors who are quick to see flaws in the price data even during this most pleasing time of low inflation.

THE WEEK AHEAD

FOREIGN TRADE

Tuesday, Sept. 20, 8:30 a.m.

The foreign trade deficit for all goods and services in July is expected to change little from its June reading of \$9.4 billion. That's the median forecast of economists surveyed by MMS International, a division of McGraw-Hill Inc. If correct, the forecast suggests that foreign trade started the third quarter larger than its average in the second, when net exports subtracted almost one percentage point from economic growth. For merchandise alone, the MMS economists expect that the trade deficit shrank to \$13 billion in July, from \$14.2 billion in June. Imports were

probably flat after rising 3%. And exports likely increased 2.3% after advancing 4.3% in June. The recent pickup in foreign shipments would push the yearly growth in exports above the pace of imports for the first time in 2½ years.

HOUSING STARTS

Wednesday, Sept. 21, 8:30 a.m.

Housing starts probably slipped to an annual rate of 1.4 million in August, say the MMS economists. In July, starts bounced back by 4.7%, to 1.42 million, after bad weather in June. The August number is indicated by the small decline in construction payrolls last month, as well as the decline in loan applications

to buy a home. Higher mortgage rates are starting to crimp building activity. Housing starts peaked back in the fourth quarter of 1993.

FEDERAL BUDGET

Thursday, Sept. 22

The MMS forecast is that the federal government will post a \$24 billion deficit in August, not very different from the \$23.1 billion recorded a year earlier. With just one month to go in fiscal 1994, the deficit is on track to total less than \$200 billion, the lowest deficit since 1981. Receipts are growing far faster than outlays, allowing Washington to mop up some of its flood of red ink. In 1993 the federal deficit hit \$255 billion.

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QUIET CRACKDOWN

THE QUARRY: CORPORATE CIVIL-RIGHTS VIOLATORS

Back in 1977, the federal government accused Honeywell Inc. of discriminating against women. The issue: The Minneapolis company printed internal job listings for heavy industrial jobs on blue paper—a code meant to discourage female applicants. The case languished during the 12 years that Republicans Ronald Reagan and George Bush lived in the White House. But a new squad of civil-rights cops in the Clinton Administration revived the matter and quietly forced Honeywell into a \$6.5 million settlement on Sept. 8.

There's plenty more to come. With little fanfare, the Administration's antidiscrimination troops are gearing up a tough national enforcement drive. The crackdown's targets range from polluters who dump their muck in minority neighborhoods to companies that discriminate in hiring to banks whose loan departments redline poor areas. Business, perhaps preoccupied with issues such as health-care reform, has hardly noticed. "This wasn't on our radar screen," says Michael Rousch, a lobbyist for the National Federation of Independent Business.

MOMENTUM. Yet signs of the tougher new policy are everywhere. The U.S. Commission on Civil Rights' planned Sept. 21 hearings on Wall Street's dismal minority-employment record are only the latest example of a drive that has been gaining momentum for weeks (table). The Justice Dept. has stepped up its policing of bias in lending by banks, and it has joined the Equal Employment Opportunity Commission in more closely monitoring business discrimination against disabled Americans. The Labor Dept. is scrutinizing the civil-rights records of federal contractors. And

the Environmental Protection Agency is cooking up a new program to ensure that companies don't pollute more in poor minority neighborhoods than in other areas. "There's no question they're being more aggressive," says Stephen A. Bokart, general counsel for the U.S. Chamber of Commerce.

President Clinton's antidiscrimination drive got off to a slow start because of his ill-fated nomination of Lani Guinier for Justice's top civil-rights post. But Deval L. Patrick, the new Assistant Attorney General for Civil Rights, has been on the job for nearly six months. And Gilbert F. Casellas should be confirmed any day now as the new EEOC chairman. With them and other former civil-rights activists leading the charge as Clinton appointees, critics fret that new initiatives will impose unwieldy restraints on business. Edward Yingling, chief lobbyist for the American Bankers Assn., complains that in at least one case "the government seems to be making the standards as they go along. That is scary to us."

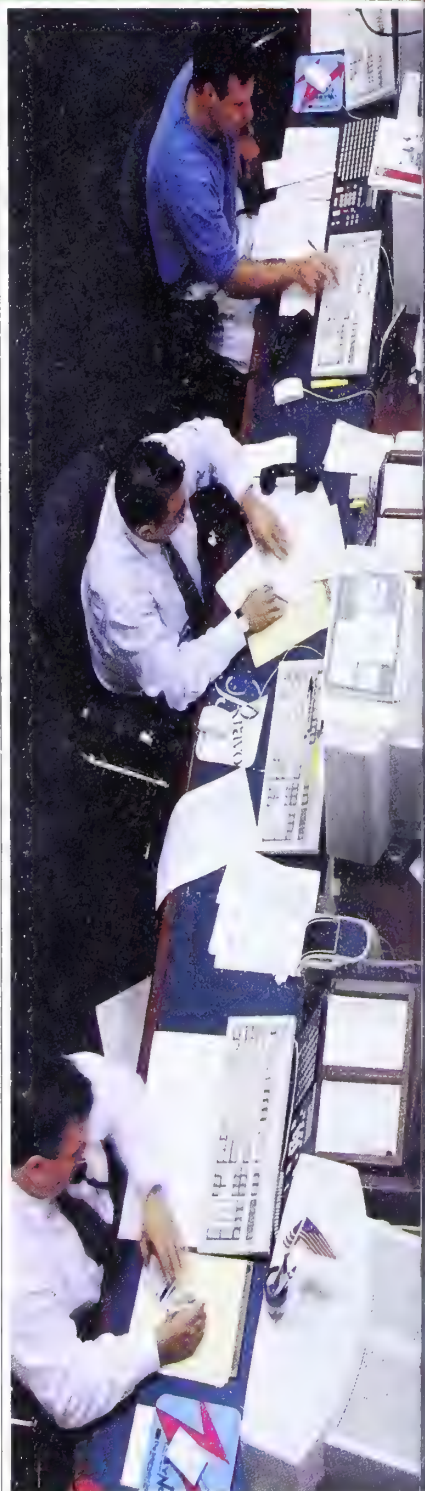
Indeed, Justice and Treasury Dept. bank regulators are aggressively pursuing banks for unfair lending practices. The government has entered into four settlements so far. The one that irks

Yingling is a controversial Aug. 22 deal suburban with Maryland's Chevy Chase Federal Savings Bank. Chevy Chase denies Justice's allegations that it adopted a policy to avoid black neighborhoods. But it agreed to provide an additional \$11 million in subsidized loans and new branches in those areas.

The banking industry fears that the government is exacting overly harsh



The President's civil-rights team has mounted an enforcement drive that could affect an array of industries nationwide



remedies in cases such as Chevy Chase. "This is credit allocation, and it's undue interference," fumes Washington banking consultant Edward E. Furash. But Justice's Patrick counters: "We're not seeing any particular remedy other than the elimination of unfair lending."

Right or wrong, many companies are reluctant to fight back. The cost of litigation is steep, and the bad publicity

CLINTON'S ANTIBIAS BINGE

SEPT. 21 The U.S. Civil Rights Commission plans hearings on Wall Street's minority-employment record. The inquiry will lead to recommendations for action by the White House and Congress.

SEPT. 8 The Labor Dept. reached a \$6.5 million accord with Honeywell, settling a 19-year dispute over alleged discrimination against women employees. Labor is actively policing other government contractors to root out discriminatory practices.

SEPT. 6 The Justice Dept. reversed its position in a case involving a laid-off white New Jersey schoolteacher. The Bush Administration backed the teacher's claim of reverse discrimination when she was fired instead of a black teacher, but the Clintonites say that employers sometimes can choose a minority over an equally qualified nonminority.

SEPT. 1 Justice announced an agreement with Avis that requires it to provide hand-operated rental cars to disabled people. Justice is investigating 10 other rental-car companies on the same matter.

AUG. 22 Justice reached a settlement with Chevy Chase Federal Savings Bank requiring the D.C.-area bank to open more branches and to make more investments and subsidized loans in black neighborhoods. It has also stepped up investigations of lending discrimination generally.

lated East Coast and Midwest, where utilities have often "slammed" power plants into poor areas, says Scott E. Berger, senior environmental scientist for Public Service Co. of New Mexico.

The environmental drive is already gaining speed. On Sept. 7, the EPA, the U.S. Centers for Disease Control, and related agencies launched the Mississippi Delta project to study the effects of pollution on residents in that highly industrialized area. The EPA aims to start a potentially costly emission-reduction program, and other agencies will provide medical assistance to residents.

MISPLACED? The EPA also has targeted a Chicago public-housing project built on a landfill and surrounded by 11 polluting industrial plants. "No community, just because it's poor or minority, should become the dumping ground of waste," says Clarice E. Gaylord, director of the EPA's Office of Environmental Justice.

Companies grumble that the govern-

ment is changing the rules on businesses long after they got lawful permits to build. Moreover, "the charge of racism may be misplaced in some of these situations," says Charles J. McDermott, government affairs director for WMX Technologies Inc.

Another controversy is brewing at Justice over an affirmative-action case involving a white teacher, Sharon Taxman. She had sued the Piscataway (N.J.) Board of Education in 1992 for dismissing her rather than a black colleague of equal seniority and ability. She won in U.S. District Court. But on appeal the Clintonites reversed the Bush Justice Dept.'s brief

in support of Taxman. Now, Justice argues that employers can use affirmative-action goals to justify retaining minorities over comparably qualified whites.

Some legal scholars allege that if Justice's view prevails, the case could lay the groundwork for expanded racial preferences—and even quotas. That could force companies to expand diversity programs—which could inflame white work-



PATRICK
Justice's new Assistant Attorney General for Civil Rights will soon be joined by a new chairman of the EEOC

may be costly for image-conscious execs. that makes settling and suffering in since the preferred option. "It was a prudent decision to put it behind us," says Andrew L. Sandler, an attorney for Chevy Chase.

Probably the most perplexing new civil-rights issue confronting business is the administration's "environmental justice" initiative. In February, the President or-

dered the Environmental Protection Agency to come up with a plan to protect poor minority communities from getting hit with an unfair share of pollution. Studies have shown that a disproportionate number of hazardous-waste dumps, pollution-spewing factories, and even utility plants are located in such neighborhoods. Now, that could be a problem for utilities in the densely popu-

Top of the News

ers. "The Administration is giving top management a machine gun to go after expensive, middle-aged white males," claims Frederick R. Lynch, a professor of government at California's Claremont McKenna College.

Even the White House worries that its troops may be going too far. The Housing & Urban Development Dept. has already backpedaled from a contro-

versial policy. HUD had begun an inquiry into neighborhood protests against a proposed low-income housing development in Berkeley, Calif. The investigation was prompted by housing activists' charges that the opposition was based on bias against substance abusers, who could be considered disabled. HUD dropped the matter in August, and the agency now says it will no longer investigate activi-

ties protected by the First Amendment.

Like business, Clinton has been preoccupied and hasn't paid much attention to his zealous antibias cops. But if he continues to give them free rein, companies may find that settling without a fight is too high a price to pay.

By Catherine Yang, with Amy Barre in Washington, Richard A. Melcher in Chicago, and bureau reports

IS WALL STREET FINALLY STARTING TO GET IT?

It was hearing women employees complain about the scantily clad dancers at Merrill Lynch & Co.'s 1992 Christmas party that finally convinced Chief Executive Daniel P. Tully that it was time to act. In the six months before the party, Tully had heard about six other incidents of alleged sexual harassment at his firm. Merrill had already formed a committee to study bias and implement measures to recruit and retain more blacks and women. But Tully's concerns got things moving. Says Roger M. Vasey, the Merrill executive vice-president who is leading the firm's effort: "This program has teeth."

Wall Street could use one. The industry has a record of not hiring many women and minorities—and failing to protect them from bias once on the job. Now, with the Clinton Administration cracking down on civil-rights violations across the economy and the U.S. Civil Rights Commission holding hearings on Sept. 21 to examine the financial industry's record, Wall Street has good reason to clean up its act.

Just how bad is the Street's record? Pretty dismal. There are virtually no women and blacks in top management at the major firms. Of 546 managing directors and directors at Merrill, just 57 are women; only 38 are black, Asian, or Hispanic. At Goldman, Sachs & Co., there are just seven women and one black out of 150 partners. Salomon Brothers Inc., which also has a diversity committee, has just one black trader.

Merrill is one of the few firms taking action. Vasey, a heavy hitter who used to run its fixed-income depart-

ment, has an annual budget of \$1 million for his diversity committee. Merrill now awards up to 10% of the bonuses to its 10 executive vice-presidents on the basis of eight criteria, including recruitment, retention, and career development of minorities and women—with progress monitored quarterly.

Some significant steps have already been taken. Merrill also has doubled paid maternity leave to three months, for instance, and it now has a screen-

man Sachs has installed a day-care center in the lobby of its building that provides backup child care. Morgan Stanley & Co. has hired a full-time consultant to work exclusively on diversity issues and has assigned William M. Lewis Jr., an African American managing director in investment banking, to head its diversity task force. Among measures taken so far: Morgan has started a \$2.5 million scholarship program in which it sponsors

promising college students in their junior and senior years as interns. And last year, for the first time, it began recruiting at five historically black colleges.

There are skeptics, of course. New York lawyer Jeffrey L. Liddle, who will be testifying at the Sept. 21 hearings, calls Wall Street's efforts at diversity "a cruel joke. Those committees do nothing." The companies, critics contend, are acting mainly to avoid lawsuits. For example, in December, 1993, 10 former and current African American Merrill employees from San Francisco branches filed a complaint with the National Association of Securities Dealers alleging that Merrill discriminated against them

on the basis of race. Merrill says in a statement that it "is outraged by these meritless claims."

Now, Wall Street is under intensified pressure. Many state and federal agencies require detailed information on the number of women and blacks in senior positions at financial companies bidding for their business. And with the feds on the case, Wall Street may have to get more serious about promoting equality.

By Leah Nathans Spiro in New York



Financial firms are addressing historically unequal hiring and treatment of women and minorities. Goldman Sachs now offers emergency day care

ing process to make sure it doesn't hold corporate outings at golf clubs that discriminate. It's also trying to boost the number of women branch managers—now only six out of 325—by not forcing them to move all over the country as a prerequisite for a promotion. And it just added former Securities & Exchange Commissioner Aulana Peters, a black woman, to its board.

Other firms also are getting started. To help retain female employees, Gold-



ELsie MAY BE AILING, BUT KKR IS THINKING WHIPPED CREAM

Borden could lead its buyer into green pastures—perhaps through sell-offs

say the least, 1993 was a very difficult year for everyone with a stake in Borden.... All felt the impact of Borden's poor performance.... We want you to know that a new era has begun....

Acknowledging that your company is in trouble is hardly an encouraging way to begin an annual report. But Borden Inc. Chairman Frank Borden and CEO Ervin R. Shames must have figured there was no point denying the obvious. Through a flawed acquisition strategy, Borden's former top brass had left the company indebted and unprofitable. The best Tasco and Shames could do was put a good face on Borden and hope someone would gobble it up. Someone finally did. On Sept. 12, Kohlberg Kravis Roberts & Co., the New York leveraged buyout firm that owns RJR Nabisco Holdings, Safeway Stores, and Stop & Shop, among other companies, announced it would pay \$2 billion for an 80% stake in Borden. Nabisco will purchase the remaining 20% with an option to take over a further 10% from KKR. Borden shareholders will receive \$14.25 a share—in Nabisco stock. **STEAL.** The all-stock, no-cash deal is hardly a bonanza for Borden shareholders, who have watched their shares plummet from a high of more than 35 in 1992 to 11% just before the deal's announcement. The stock jumped two points on the news. But the deal is practically a steal for KKR, which will earn a \$35 mil-

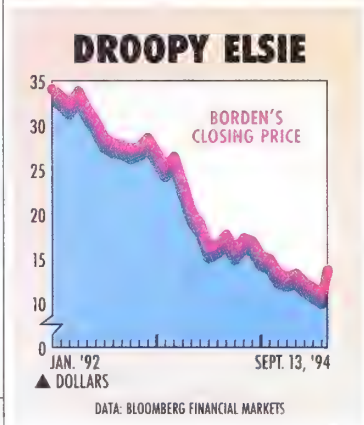
lion fee from Borden if it falls through—and a \$30 million bonus if another bidder takes the company with a higher offer. Although Borden lost almost \$1 billion in the past two years, the \$5.5 billion company still owns such well-known brands as Cracker Jack, Wise potato chips, Creamette pasta, and Classico tomato sauce. Other holdings include a \$1.4 billion dairy business and a \$1.9 billion chemical operation that makes Elmer's glue. "For someone who has assets, there is value at Borden," says Robert Monks, a principal at Lens Inc., which owns 1.7 million Borden shares. Indeed, some investors gripe the KKR bid is way too low. "If the board really believes that is the best possible deal for Borden shareholders, they're smoking something besides cigarettes," says Prudential Securities Inc. analyst John M. McMillin. But KKR's offer is probably as good as shareholders will get. Borden has been on the block since January. Hanson PLC expressed interest in buying the chemical business last Christmas but backed off. Borden investment banker Lazard Frères found no other suitors. Nabisco, moreover, may need Borden almost as much as Borden needs help. "Nabis-

co has done all it can to sustain momentum," says Joel Weiner, a former Kraft-General Foods executive and a Nabisco shareholder. "To keep its stock moving, [KKR] has to do acquisitions." **"BIG LIE."** With Nabisco's marketing savvy, Borden's foundering but famous brands, and KKR's deep pockets, both food companies can now expand aggressively. KKR says that Borden and Nabisco "will be operated completely independently." Don't bet on it. RJR CEO Charles M. Harper will probably take a seat on Borden's board. And food analysts predict Borden will be broken up and absorbed into Nabisco. Says McMillin: "I know [KKR] said they were not going to sell any of it, but that is a big lie from my standpoint."

Most likely to get tossed: Borden's chemical and dairy divisions. Analysts estimate that KKR could get \$2.3 billion for the chemical division, which earned \$168 million last year, and \$100 million to \$150 million for the unprofitable dairy operation, which includes Meadow Gold milk products—and Borden milk, famous for its Elsie the Cow logo. H. J. Heinz Co. and Dean Foods Co. are hungry for an asset sale. "This offers us opportunities," says Howard M. Dean, chairman and CEO. Adds Heinz CEO Anthony J. F. O'Reilly: "Borden has some good products. At the right price, [we] would be interested."

Nabisco also may find plenty of ways to wring profits from Borden. For instance, Steve Michaelson, a former Borden marketing executive, says that Nabisco's Fleischmann's margarine division has tried to persuade Borden to license its name for a new, fat-free cottage cheese. And Borden's pasta, sauce, and Wise chips could go well with Nabisco's Ortega Mexican-food business, says Mike Shantull, a former Nabisco executive who is now a partner at Meridian Consulting Group, which writes Ortega's annual marketing plan. Turning Borden around "is a classic case study of what KKR does best," says Burt P. Flickinger III, a consultant at A.T. Kearney & Associates. If he's right, this deal could bring a healthy moo from Elsie.

By Laura Zinn in New York, with Greg Burns in Chicago and Keith L. Alexander in Pittsburgh



PHOTOGRAPH BY ISA O. INCHES/BLACK STAR CHART BY ISA KNOUSE BRAININ BW

Commentary/by Mike McNamee

A MIDDLE-CLASS TAX CUT COULD BLOW UP IN BILL'S FACE

Memo to: The President
From: Independent Economic Brain Trust (INDEBT)
Re: Middle-Class Tax Cuts

Mr. President:

Per your request, we've investigated the economic and political case for tax cuts targeted to the middle class. Our examination has been preliminary, recognizing that this proposal is not an official Administration initiative; as Labor Secretary Robert B. Reich told us, "there's more smoke than fire." But with your advisers increasingly worried that the economy may slow between now and 1996, many of them are floating ideas to stimulate demand, increase your standing with average Americans, and counter the "pro-family" platform Republicans will unveil on Sept. 27.

We recommend that you approach tax relief for the middle class—by some definitions, 60% of America's families—with great caution. Because of pay-as-you-go budget rules, a tax cut wouldn't have a stimulative effect on the economy. Nor would a tax cut reverse the income declines suffered by most middle-class families during the past 15 years. And while tax cuts are hugely popular, the debate could reopen deep divisions between your economic and political advisers, trigger a battle in Congress—and hand the GOP a winning issue.

Background: In the early days of your 1992 campaign, Mr. President, you advocated tax cuts for the middle class. But other Democrats ridiculed the idea, and you switched to a cheaper plan to give working-class parents a tax credit for each child. By the time you unveiled your 1993 deficit-reduction plan, the tax cut was shelved.

It resurfaced last January when Robert J. Shapiro, chief economist of the moderate Progressive Policy Institute, proposed substantial cuts in federal subsidies and tax breaks for the energy, agriculture, transportation, and

aerospace industries. Cutting subsidies, he calculated, could free up \$225 billion over five years for deficit reduction, spending on education and training, and a \$350-per-child tax credit for lower- and middle-income families. The credit's cost: \$14 billion a year.

Economic impact: Shapiro's proposal follows current budget rules, which require that any tax cut be offset by raising other taxes or by cutting spending. With no change in the deficit,

Lawrence Mishel, an economist at the liberal Economic Policy Institute.

Shapiro argues for a pro-family policy that would exempt families from taxes on the basic costs of child-rearing—say, \$5,000 a year per child. You could do that by doubling the current \$2,450 personal exemption or by adding an equivalent \$350-per-child tax credit.

Administration dynamics: But small tax cuts would do little to replace the middle class's lost income. And debate

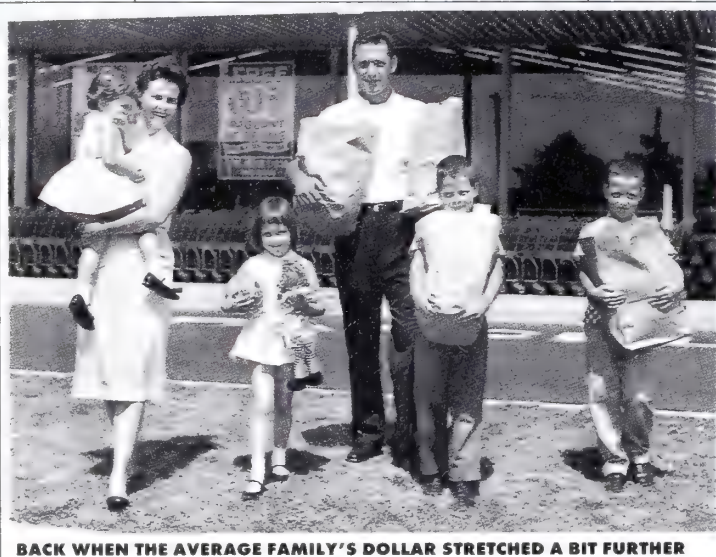
over what type of cuts to make would once again highlight your Administration's divided economic camps. Centrists, such as Shapiro, urge pro-family tax cuts. Liberals, such as Reich, will argue that any spare cash can better be used to create public-service jobs or for training programs. Conservatives such as Treasury Secretary Lloyd M. Bentsen would rather reduce the deficit or fund savings incentives, such as the "Super IRA."

Political benefits: Compared to your economists' political advisers appear unified. But contrary

to their claims, the tax cut is not a guaranteed winner. To fund it, you would have to confront either business interests—which would fight subsidy cuts hard—or the elderly, whose Medicare benefits might have to be reduced. In Congress, such GOP leaders as Newt Gingrich would propose bigger tax cuts funded with appealing but phony budget tricks, such as unenforceable caps on entitlements. You would wind up on the defensive.

In short, Mr. President, the middle-class tax-cut issue is a minefield. It won't win points as economic policy and could explode politically. You were right when you buried the idea in 1993. You would be smart to leave it buried now.

McNamee covers social policy from Washington.

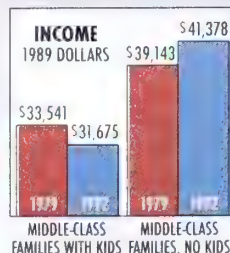


BACK WHEN THE AVERAGE FAMILY'S DOLLAR STRETCHED A BIT FURTHER

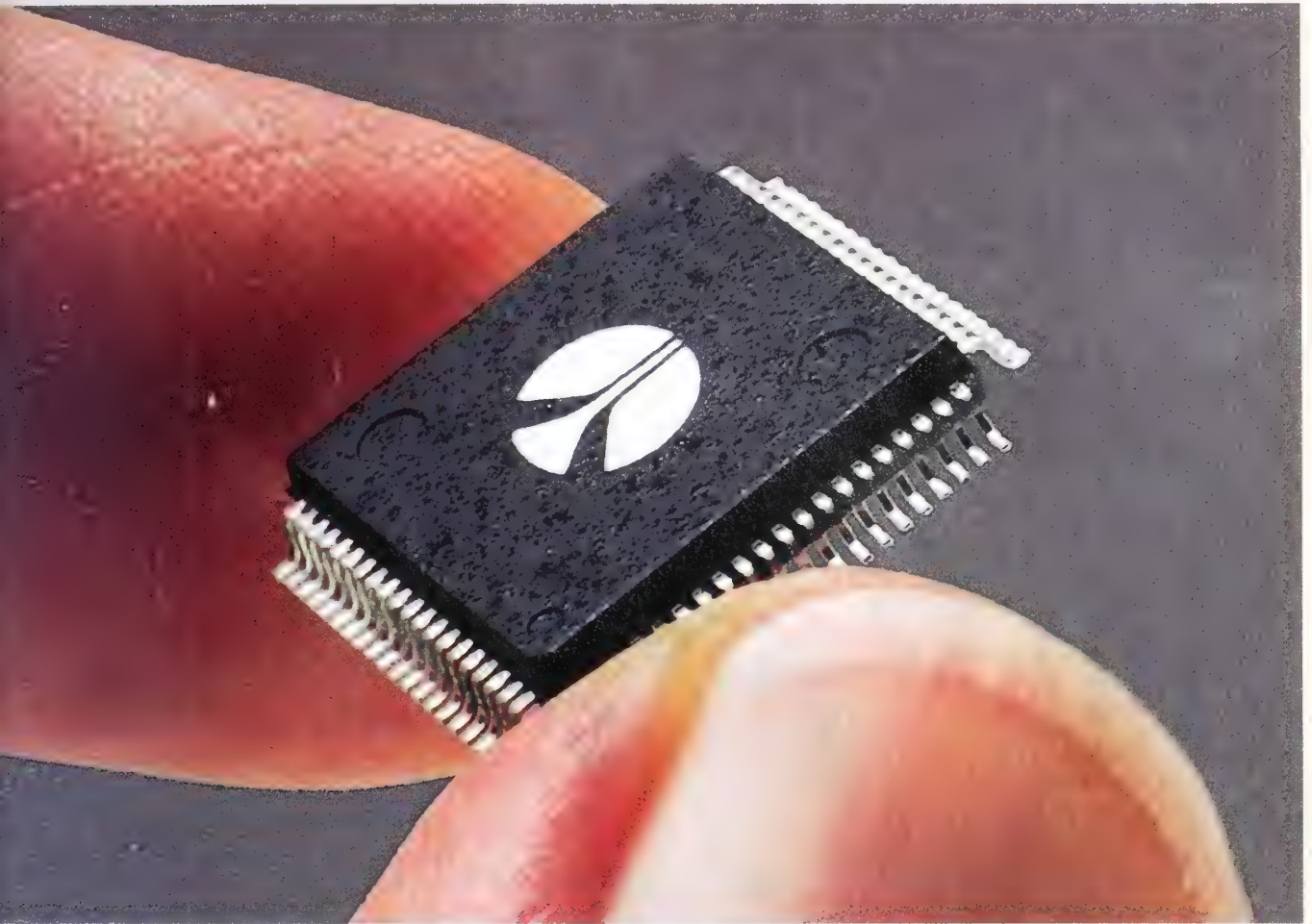
there's no stimulus: "If you pay for a tax cut, it is not a macroeconomic event," says Federal Reserve Vice-Chairman Alan S. Blinder. Liberal Democrats propose legislation to waive the budget rules if the economy slows. But that would cost you credibility with the bond market and drive up long-term interest rates.

Social policy effects: Tax cuts could be justified on social, if not economic, grounds. As you stated in your campaign speeches, middle-income Americans have suffered for years (chart). From 1979 to 1992, average paychecks adjusted for inflation declined, especially for families with kids. And the expansion has barely begun to repair the damage. "American families have been working harder for less," says

THE MIDDLE CLASS GETS WHACKED



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ARE BASEBALL'S PLAYERS GETTING CAUGHT IN A RUNDOWN?

The bargaining edge is shifting to the owners as the strike drags on

Baseball hasn't been a pretty sight since the strike began in mid-August—nothing but empty stadiums, angry players, and stone-faced owners. Now, things could get truly ugly. With the '94 season dead, it's increasingly likely the standoff will drag on into the spring. If that happens, Major League Baseball will have to sell tickets for a season that may never happen. And many players won't know which club they'll be suiting up for—or even if they'll have a spot in *The Show*.

Amid all the confusion, however, it seems clear that the balance of power is tipping away from the players. The union has won all seven labor disputes of the past two decades, but it has never ended a season on strike. Come October, more than 200 senior players will be free to sell their services to the highest-bidding teams. The union will want them to sit tight until a new pact is signed. But owners will insist

that anyone who doesn't snap up what's offered could miss the best deal if MLB prevails in the end. That's a situation players never had to face before, and it could put a tremendous strain on the union's unified front. "The relative amounts of pressure will shift away from owners to players," says Gary R. Roberts, a Tulane University law professor who's an expert on sports labor.

NIGHTMARE. Of course, the owners face a mess of problems, too. The 200-odd players due to become free agents will be eligible to switch teams. Usually, many would have sorted out their new deals by yearend, leaving clubs able to promote ticket sales with their names and run national and local television ads adorned with their faces. Owners will face a nightmarish marketing task if it isn't clear who's on first (and second and third) at each team—or whether they'll play ball at all.

Making a salary cap work during a strike could be even more daunting. With this season over, the owners can impose their last contract offer, under which the total of all player salaries would not exceed 50% of total baseball revenues. Each team then would have four years to bring payrolls to 50% of the sport's average. But without knowing which free agents are staying put, some clubs could face tough decisions. For instance, the Atlanta Braves dished

though the owners have won this battle in the past, public anger over another lost season could stiffen congressional attitudes.

The ballplayers could face even worse dilemmas. They've been able to have tough in the past in part because they collect a paycheck twice a month from Opening Day on. So when the union calls a strike in midseason, as it did this year, players already have earned the bulk of their annual salary. The owners, by contrast, get the biggest chunk of their revenue from the league championship playoffs and World Series. If they stand to lose more, proportionately as the season slips away. The situation will reverse next year, though, when owners will face little pain early on as players will forgo pay right off the bat.

The union's biggest test will be how to handle the new crop of free agents.

In past disputes, players' individual salaries were never immediately at issue. The reason: The two sides always reached an agreement before the season ended. This year, however, some free agents could lose if they stick with the union while their colleagues buckle. Some stars sign deals that put a team over the salary limit, then the team couldn't sign another expensive player. So a player who held back could be forced to seek work elsewhere.



GOODBYE MR. SPALDING

out \$52 million in salaries this year, vs. an MLB average of \$36 million. To meet the cap, "they probably couldn't keep players like Steve Avery," a Braves pitcher who earned \$2.8 million this season, says Scott Boras, Avery's agent.

Owners must also keep an eye on Washington. Representative Jack Brooks (D-Tex.) has scheduled a Sept. 22 hearing to look again at repealing Major League Baseball's antitrust exemption—which would open the way for a suit by the union against the salary cap. Al-

"The pressures on free agents to sign are enormous as they watch a very short career go by"

"The pressures on free agents to sign are enormous as they watch a very short career go by," says Marvin Miller, former head of the Major League Baseball Players Assn. "But I still don't think anyone will cross the picket line." Agrees Boras: "I don't believe any player would sign" under a salary cap.

Given the likelihood of such a muddle, the two sides may well come to terms in time to salvage next season. That would probably have to happen by November, negotiators say. "Both parties face enormous uncertainties, which gives them tremendous interest in trying to settle this," says Richard Ravitch, the owners' chief negotiator. If baseball remains in warring camps through the winter, however, bringing peace to the national pastime will be ever more complicated come spring.

By Aaron Bernstein in New York, with bureau reports

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THE MACHINE-TOOL INDUSTRY SHOW IN CHICAGO SHOWED OFF A NEW PRODUCT THAT SHAPES RAW METAL

U.S. MACHINE TOOLS ARE CLANKING AGAIN

Manufacturing is up, and so are orders for gadgets that grind, cut, or drill

Consumers just can't seem to get enough of those Ford Explorers and Jeep Grand Cherokees. So Dana Corp. is making axles three shifts a day, seven days a week. "We're at capacity," says Daniel Hendricks, controller at Dana's Spicer Axle Div. in Fort Wayne, Ind. Dana's response? Invest \$70 million in new equipment: gear-cutting, grinding, drilling, and other machine tools.

Dana isn't the only company buying such goods. As American industry moves into overdrive, one of its most beleaguered businesses—the U.S. machine-tool industry—is getting back on its feet. Amid the thousands of attendees at Chicago's McCormick Place for the industry's biennial trade show—which wrapped up Sept. 15—was a pervasive sense that the poster child of America's industrial decline is making a comeback.

INTERNATIONAL APPEAL. The rebound bodes well not just for this \$5 billion business but for all of U.S. manufacturing: Machine tools are the "master tools" that make everything else. "It's a bellwether for U.S. productivity," says Daniel J. Meyer, chairman of machine-

tool maker Cincinnati Milacron Inc. Adds Berthold Leibinger, chief executive of top toolmaker Trumpf & Co. in Germany: "America has realized that a nation must produce hardware, not just software and services."

Orders to U.S. toolmakers were up 24% in the first seven months of 1994, to \$2.5 billion. The news was even better for producers of presses and other metal-forming equipment. Powered by auto makers and their suppliers, which shape a lot of sheet metal, orders have shot up 55%. And the order runup may have legs: The average age of the metalworking machines used in the U.S. hit an all-time high in 1993. "There's a tremendous pent-up demand in the machine-tool industry," says Brian McLeod, sales and distribution chief at Fadal Engineering Co.

American machine tools are becoming more popular overseas as well. Ex-

ports for the first half are up 24.2%, to \$68 million, boosted in part by China's torrid economy and big orders from Canada. "What surprises us is our international business," says Milacron's Meyer, who sees demand percolating in most of the regions throughout the world.

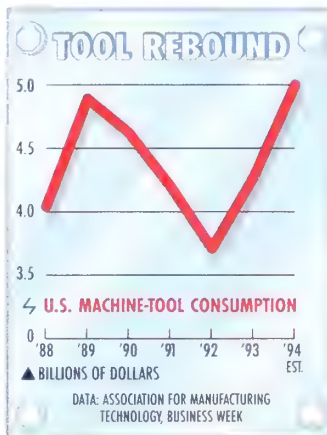
Still, overseas competitors are more than keeping up, particularly the Japanese. Imports are claiming 50% of the U.S. market this year despite price increases, an uptick from the 40% or so they have enjoyed since the 1980s. A strong U.S. market is sucking them in, while the expiration of voluntary trade limits by Japan at the end of last year is contributing, too.

The weak dollar also is helping some Japanese toolmakers. U.S. transplants including Japan's Mazak and Okuma America, which invested heavily in U.S. production during the '80s, now rank among the major domestic producers. Okuma America's business "is the best it has ever been," says President John Hendrick.

TRIMMER BACKLOGS For American machine-tool makers, the challenge now is reversing a decade of weak demand, consistent management, and ownership changes that crippled the industry. But executives say they are up to the challenge. Many of them are determined not to let backlogs swell as they did back in the early 1980s, a problem that opened the door to imports that in turn captured half of the U.S. market.

Machine-tool executives are saying customers have made it clear they can't raise prices much—even in the face of strong demand. They are working on cutting costs and hiring only sparingly. Profits, though, are soaring as they have done in past cycles. Still, the American machine-tool industry at long last is reversing its decline. That's something for business to cheer about.

By Zachary Schiller in Chicago



THEY NOT ONLY
SOUND GREAT,
THEY PUT PRODUCTIVITY
IN MOTION.



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Commentary/by James C. Cooper

THE NEW GOLDEN AGE OF PRODUCTIVITY

Is the U.S. in the middle of a productivity revival or not? The answer will affect American living standards, inflation, and global competitiveness for years to come.

The data give the productivity believers plenty of ammunition. Of course, not everyone agrees with the numbers. Some argue that the recent improvement in productivity is no better than in past upturns and that measurement problems overstate the recent gains. However, by examining the dramatic changes in the U.S. economy in recent years, it's easy to see why the optimists are probably right.

Defined as output per hour worked, productivity is influenced by everything from the skill levels of workers to the technology they use to the way a company is organized and managed. Thanks to Corporate America's restructurings and high-tech investment, the long-term trend of productivity growth is on a path not seen since the 1960s. In the 1970s, productivity limped along at 1% annually. The 1980s were worse. But in the first 4½ years of the 1990s, it has rebounded to nearly 2%. Of course, the decade is only half done. And productivity surged after the recessions of the '70s and '80s, only to dive later.

INVESTMENT BOOM. The infidels say the same thing will happen this time. "We see no evidence that the rise in productivity in this expansion is anything more than a normal cyclical rebound," says David A. Wyss, research director at DRI/McGraw-Hill. Productivity usually pops up early in a recovery. Later on, however, as companies have to hire new workers who need to learn the ropes, it begins to slip. Indeed, second-quarter productivity fell 2.5%, as a million workers found jobs.

But this time, even as the cyclical gains fall away, the data strongly suggest that the structural improvement remains in place and that the short-term drop-off will be less steep. Even

with last quarter's dip, productivity is still up 2.3% from a year ago. Its pace for the entire expansion is above that of the recoveries of the '70s and '80s. And productivity gains have made the largest contribution to growth in any expansion since the 1960s.

The most compelling argument for the productivity revival is the staggering rate at which companies are making efficiency-enhancing invest-

as Commerce suggests, because after it's only a glorified typewriter.

However, arguments abound on the other side. Commerce says the price of telecommunications equipment is rising. But it's obvious that prices are declining for a wide array of such hardware, from fax machines to computer modems, hinting that investment in this fast-growing area is understated.

Moreover, the government is probably underestimating service productivity. Commerce doesn't even measure it in many service industries—unlike manufacturing, you can't just count the widgets. It's hard to believe that service productivity fell as badly in the first half as the numbers imply, especially when manufacturing efficiency soared 5.6%. Indeed, services account for 75% of 1994's planned outlays for new plants and equipment.

HARD FACTS. "If you really want proof of the productivity revolution, look at manufacturing," says Bruce Steinberg at Merrill Lynch & Co. There

he says, no doubt exists about what we are measuring. Factory productivity is up a stunning 5.4% during the past year. With factory wages up only 2.7%, unit labor costs have plunged 2.7%. That means many factories can easily absorb the recent uptick in prices of materials while barely feeling the effect on their bottom lines.

Extend that phenomenon to properly measured service productivity, and

it's easy to see why the inflation outlook remains so good (chart) and why the '90s will be looked back on as a watershed in the advancement of U.S. competitiveness and living standards.

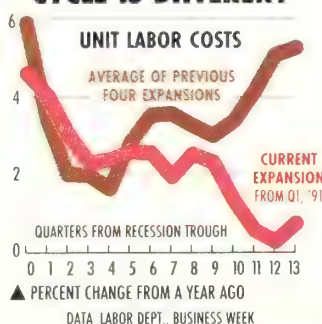
Cooper is *BUSINESS WEEK's* senior economist.



ments. Since the investment boom began, equipment outlays have soared 43.2%, the fastest nine-quarter growth ever. The boom isn't abating, as businesses increase their 1994 budgets yet again. Outlays are slated to rise 9.4%, after adjusting for capital-goods prices.

But that price adjustment is where the argument gets hot. Wyss and other disbelievers say the upturn in business investment is also normal. They say the Commerce Dept.'s adjustment for quality improvements in computers results in sharply declining prices, causing an overstatement of price-adjusted investment. Wyss argues, for example, that a laptop computer is not "bigger and better" than the old mainframe it replaces,

WHY THIS INFLATION CYCLE IS DIFFERENT



look at the figures.

Financial highlights (billions of lire)	1989	1990	1991	1992	1993
Sales	17,727	19,964	22,964	27,173	29,782
Purchase of tangible fixed assets	8,930	10,610	11,827	10,596	8,397
Number of employees	122,653	125,958	129,492	137,887	136,184
Net tangible fixed assets	35,840	40,460	46,451	49,863	49,490
Net financial liabilities	14,314	17,521	19,506	22,916	22,085
Gross operating profit	8,861	9,822	11,672	13,683	14,843
Profit before tax	2,208	2,318	2,533	2,823	3,284
Net profit	1,355	1,367	1,413	1,425	1,539
part attributable to STET	949	958	971	965	1,014
Cash-Flow	6,727	7,380	8,636	9,459	10,126
as a percentage of capital expenditure	75.3	69.6	73.0	89.3	120.6
Net financial charges on sales (%)	6.7	7.0	7.0	7.5	6.5
Profit before tax on sales (%)	12.5	11.6	11.0	10.4	11.0

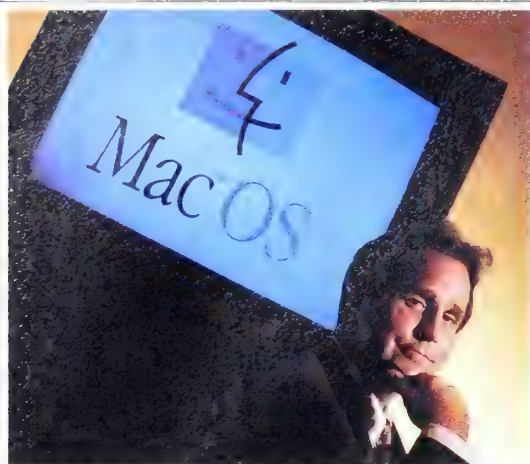
The figures speak for themselves. They confirm the STET Group as one of the most promising companies in the international marketplace, whose remarkable performance is continually improving. And there's more. The restructuring of the Italian telecommunications industry, put forward and developed by Stet, is now a reality, managed by Telecom Italia, the sole company responsible for telecommunications in Italy resulting from the merger of SIP, Italcable, Iritel, Telespazio and Sirm. Under Telecom Italia, the management of the various services will be integrated so that resources can be exploited fully, costs contained, investments rationalized, quality and range of services improved. Thus the STET Group is poised to compete worldwide with the help of a policy of partnerships and initiatives, research in the latest telecommunications software, strong manufacturing and plant activity, timely installation of new multimedia services. For these reasons, as well as the achievements of 1993, the one hundred and more companies in the Stet group and their 137,000 employees look to the future with confidence, assured that they are on the threshold of a new and productive era in the evolution of telecommunications. In Italy and the world.

low look ahead.



TELECOMMUNICATIONS
IN ITALY AND THE WORLD

COMPUTERS



DON STRICKLAND: FORCED TO FISH FOR SMALL FRY

ANYBODY WANNA CLONE A MAC?

Apple has a licensing scheme, but it may be too little, too late

Apple Computer Inc. is putting a happy face on its uphill efforts to license software and hardware, attempting to open the door to the first Macintosh clones. But is anybody else smiling?

On Sept. 19, the Cupertino (Calif.) company will unveil a fresh licensing strategy and a new smiley logo to be used by Mac software publishers and potential cloners—much like the one Microsoft Corp. uses to push its Windows operating system. But after nine months of preparing its plan, a critical piece is missing: any big-time takers. "I wish [the process] were faster, for sure," says Apple Chief Executive Michael H. Spindler. "But on the other hand, we want to do it right."

"WET SAND." Since the Mac was introduced in 1984, Apple has raked in fat margins on its proprietary technology, even at the expense of market share. In 1984, Mac hit the market with easy-to-use icons and snazzy graphics. But Apple has introduced no market-wowing changes in the decade since, while Microsoft has been catching up with its Windows operating system. With the Mac-like Windows95 due next year, Microsoft will have all but closed the gap.

Critics say any clone strategy should have been pursued years ago. "Now

the window is closing," says an executive at Acer Inc., the Taiwanese computer maker that has spent 15 months negotiating a clone deal with Apple—to no avail. Apple is dithering. Meanwhile, Acer has had a look at Windows95 and is losing interest. Says a former top Apple executive: "Apple had an ice cube in the desert and everybody wanted it. They could have licensed it to everybody. Now all they've got is wet sand."

Spindler is banking on a crack in the window, negotiating with several small-potato computer manufacturers. He won't name names, but insiders say Apple has been talking to Fujitsu, Toshiba, Olivetti, Vobis Microcomputer, and Motorola. Together, these companies' share of the worldwide PC market adds up to a measly 5%.

Apple seems forced to fish for small fry because companies such as Compaq Computer Corp. and Dell Computer Corp. are simply not interested. IBM, Apple's partner in other software and chip projects, is discussing Mac licensing with Apple but isn't anywhere near an agreement, sources say.

Whatever the prospects, licensing its technology has become critical to Apple's future. Executives say the company needs to boost the share of computers that use Apple software to 20% of the PC market to keep software developers interested in writing programs for Macintosh over the long haul. With only 10% of the PC market now, Apple is unlikely to reach its goal without the help of clonemakers.

The smaller companies, Apple says, can modestly expand the Mac market without harming Apple profits. Fujitsu Ltd., for example, claims 42% of the education market in Japan—a segment Apple hasn't cracked. And Olivetti has 20% of the PC market in Italy, where Apple holds a meager 6%. "What we want in the first pass is market makers," Spindler says. "Then we'll go beyond this." To do so, Apple has assembled a 50-person licensing staff, headed by Vice-President Don Strickland.

But ask anyone in the computer industry who doesn't work for Apple what they think of the company's latest licensing strategy. Good odds the answer will be, "Too little, too late."

By Kathy Rebello in San Francisco



COMPUTERS

WATCH OUT FOR FLYING CHIPS

Compaq is bitterly attacking Intel—though it needs the chipmaker

It was just another personal-computer confab until a Sept. 12 panel discussion during which Compaq Computer Corp. Chief Executive Eckhard Pfeiffer was asked for his thoughts on Intel Corp. A steely Pfeiffer stunned attendees at the Barcelona conference by condemning the chipmaker, griping that Intel CEO Andrew S. Grove's pricing and product strategies serve only his own interests, not its customers'. Intel defended its practices.

It was by far the most public blow yet in a growing rift. In January, Compaq signed a supply deal with Intel rival

Advanced Micro Devices Inc.—breaking with Intel for the first time. And on Sept. 14, the AMD partnership got closer when Compaq unveiled a new line of Presario home PCs, all built around AMD chips.

RAPID MOVE. Now, the tensions are hitting prime time. Through yearend, Intel plans to spend \$80 million on TV ads to persuade consumers they need PCs based on its powerful new Pentium chips. Compaq will spend \$100 million on ads saying that it's the PC that counts—not the silicon inside.

Pfeiffer's main concern is Intel's rapid move away from its older 486 chip. The 486 powers an estimated 87% of Compaq's PCs, and Compaq is holding off selling home models based on the Pentium until next year. Intel, meanwhile, has accelerated production and chopped the price of the Pentium.

Still, Intel has warned for nearly a year that it would move quickly to the Pentium. Compaq hopes to buy 40%-plus of its chips from clonemakers next year but it still needs Intel. "Like it or not [Intel and Compaq] are still joined at the hip," says Oppenheimer & Co. analyst James Poyner. Maybe. But that doesn't mean they get along.

By Peter Burrows in Dallas, with Robert D. Hof in San Francisco



PFEIFFER AND GROVE: DO CONSUMERS NEED PENTIUM CHIPS?



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DEALS

SURVIVAL OF THE BIGGEST

More and more, Darwinism rules the travel industry

In Seattle, Microsoft Corp. executives make travel reservations on their own computers, then E-mail them for review by American Express Co. agents. In Phoenix, 250 Carlson Travel Network agents attend to the needs of General Electric Co.'s 222,000 employees around the globe. And in Moscow, Rosenbluth International is handling Russia travel for Chevron Corp. and other oil giants.

The travel agency business has come a long way from the storefront shop at Main and Elm. Sure, there are still some 30,000 smaller agencies around the U.S. But airline deregulation, computers, and the zeal for cost-cutting mean the \$100 billion corporate travel business is increasingly being handled by huge agencies. On Sept. 12, American Express, already the titan of travel, got even big-

ger by acquiring The Thomas Cook Group's Travel agency business. The \$375 million deal will boost American Express' agency sales to \$10 billion from about \$7 billion.

The buyout is the latest in a string of acquisitions the charge-card giant hopes will help maintain American Express as

"the Wal-Mart of the travel agency business," says Roger Ballou, president of American Express Travel Related Services Co. Carlson, the second-largest agency, has also been beefing up. Earlier this year, it merged with Paris-based Wagonlit Travel for sales of \$7 billion. "In

1985, you had to be national," says Travis Tanner, president of Carlson Travel. "In 1995, you have to be global."

CRITICAL MASS. The need to grow is a response to huge forces redefining the economics of corporate travel. Larger agencies specializing in business travel now make nearly half their fees from corporate clients—not from airlines. Big investments in computer networks let

agencies charge corporations for analyzing travel patterns. And software alert corporate travel managers when workers abuse travel guidelines.

Meanwhile, airlines are making noise about cutting their commissions to agencies, now typically about 10%. The meg-

agencies can counter such threats through purchasing muscle. But for smaller agencies who are far more reliant on airline commissions, the future is troubled. Many are forming alliances, such as Woodside Travel Trust, a Maryland-based consortium of 160 agencies with combined sales of \$1 billion. Others are

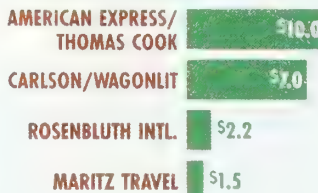
the block or on the verge of folding.

"As an industry, we're at a critical juncture," says Hal F. Rosenbluth, CEO of Rosenbluth International. "Unless you have the capital and technology to grow, you're in trouble." That's why the consolidation wave in travel agencies isn't likely to go away.

By Eric Schine in Los Angeles, with Leah Nathans Spiro in New York

AMEX: TRAVEL'S BIGFOOT

1993 U.S. REVENUES IN BILLIONS



DATA: TRAVEL WEEKLY

HOTELS

MAJOR RESERVATIONS

Will breaking Holiday Inn into many pieces work?

When he came to Holiday Inn Worldwide in 1990, Bryan D. Langton ordered 160-odd staffers to pair off and visit every Holiday Inn in the U.S. They took in peeling paint, unkempt parking lots, outdated lobbies, and enough smelly rooms to house a large army. "We saw the good, the bad, and the ugly," he says.

On Sept. 13, Langton unveiled a program to upgrade Holiday's good hotels, refurbish the ugly, and remove the big green sign from the incorrigibly bad. The company is breaking its domestic hotels into five separate segments and erasing the Holiday Inn name from its fancy Crowne Plaza hotels. In the next three months, Holiday will order its 1,080 U.S. franchisees to pony up \$500 million in repairs or leave the system. Meanwhile, the company will add 1,205 new proper-

ties worldwide, growing to a 3,155-hotel chain by 1998.

It's not Langton's first spin with big plans. After England's Bass PLC bought the chain for \$2.2 billion in 1989, Holiday Inn spent \$1 billion expanding and sprucing up. But the investment wasn't enough to make a difference in the cut-throat hotel market.

So Langton now is taking another crack. His strategy: Develop a multi-brand strategy so that customers can choose among the upscale Crowne Plaza, the traditional Holiday Inn, the budget Holiday Inn Express, and the business-oriented Holiday Inn Select and Holiday Inn Suites & Rooms. Overseas, travelers will find different brands. As many

as 200 hotels will be forced to leave the system because they won't be able to handle the \$350,000 to \$2 million needed per site to upgrade to new standards.

The response from franchisees is mixed. "You'll be telling consumers that you've got a problem with the core product," frets Robert A. Alter, president-elect of the Holiday's main franchise group. Still, others believe killing the turkeys will boost brand image. "The system needs this," says John Q. Hammonds, owner of 94 Holiday Inns.

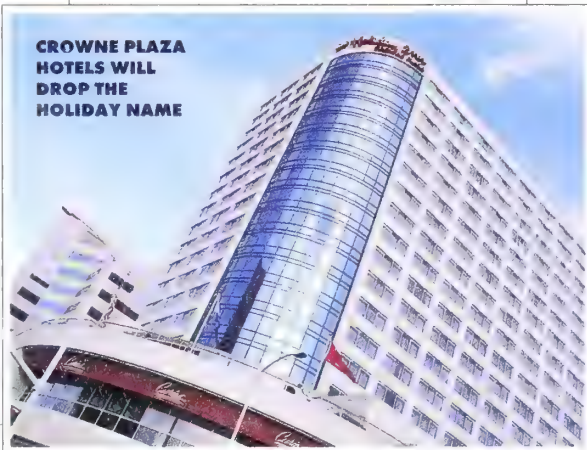
NO FEARS. Indeed, the competitive picture demands it. Fast-growing Holiday Inn Express faces tough competition from the likes of Promus Cos.' Hampton Inns and Marriott Corp.'s Fairfield Inn.

Rivals say they're not worried. Although 70% of the budget hotels will be new, converting old ones risks undermining the makeover. Says Promus Hotels Chief Executive Ray E. Schultz, "Changing the name is not going to matter a great deal."

Holiday Inn's original success grew from its dependable image as a reasonably priced, clean place for Middle America to stay. Langton's biggest challenge may be communicating just what the Holiday Inn brand means today.

By David Greising in Atlanta

CROWNE PLAZA HOTELS WILL DROP THE HOLIDAY NAME



Two Strategies for Client/Server Applications Development

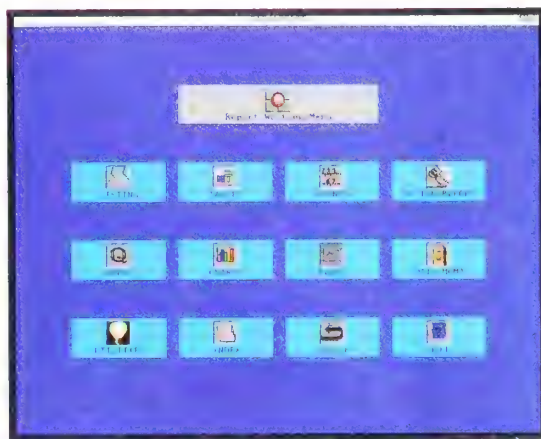
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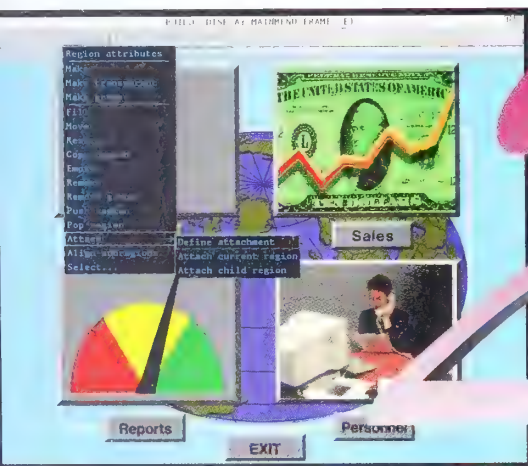
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EDITED BY THANE PETERSON

TIGHTENING UP AT THE WHITE HOUSE

White House Chief of Staff Leon Panetta finally is set to rein in President Clinton's freewheeling advisers with a long-awaited reorganization. Its key aim is expected to be an end to "floaters"—aides who have no specific jobs. Senior Adviser George Stephanopoulos, now glued to Clinton's side, will become Panetta's policy deputy. Panetta also plans to limit the use of outside political consultants, including '92 campaign stalwarts Paul Begala and Mandy Grunwald. Until Panetta replaces political director Joan Baggett next year, he will use a team ap-

proach to setting political strategy. The team members: Baggett, Deputy Staff Chief Harold Ickes, and aide Doug Sosnik.

THE MOUSE STALKS THE PEACOCK

What goes around comes around. Years ago, when RCA was looking to sell the NBC television network, Disney Chairman Michael Eisner was among those interested. Federal restrictions on studio-network combinations, and a hefty price, dissuaded him then. Now, with federal restrictions fading and NBC's current owner General Electric peddling the network, Eisner is on the phone again—with an offer sources put at \$5 billion. Disney executives won't comment officially. But insiders say Eisner feels compelled to find a distribution outlet for his films—even though he worries he is overpaying. Eisner's offer may be more attractive than a \$2.5 billion bid for 49% of NBC from Time Warner.

CORRIGAN MOVES TO THE GIANT SCREEN

Robert Corrigan, 54, who in May resigned as president of IBM's \$11 billion Personal Computer company, thinks he has a future with the big screen. On Sept. 13, Corrigan signed on as CEO of Toronto-based Imax, the leader in giant-screen motion-picture technology. While Imax had revenues of just \$41 million in the first half of 1993, Corrigan says he has ambitious plans for expanding sales of its big-screen theaters and simulator rides.

ONE OF DELL'S LAST BABIES WALKS AWAY

Dell Computer, long considered the *enfant terrible* of the PC industry, is down to its last *enfant*. 29-year-old

HEADLINER

KANTOR PAYS A PRETTY PENNY FOR GATT

It has been almost one year since President Clinton's hard-won victory for NAFTA. Now, he's pulling out all the stops to win passage of the GATT world-trade pact. But he's discovering what a difference a year—and plunging political capital—can make. On Sept. 13, Trade Representative Mickey Kantor was forced to drop renewal of Presidential "fast-track" authority as the price for getting lawmakers to O. K. GATT.

That should clear the way for congressional approval. But it could cripple Clinton's remaining trade agenda—and tie the hands of future Presidents. Under fast track, Con-

gress can only vote yes or no on trade accords—it waives the right to make changes.

With fast track jettisoned, the President and his trade team will go to November for Asia-Pacific Economic Cooperation talks. Wow and other future conferences lacking authority to negotiate down dead. Worse, Clinton may not be able to win back fast track. Hill critics who see trade policy as captive of business elites eager to surrender U.S. sovereignty to cash in on a global economy, are itching to limit Clinton's trade power. With all that at stake, GATT had better be great.

By Douglas Harbree



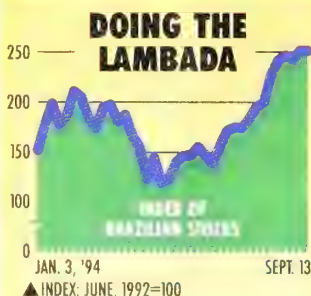
CEO Michael Dell remains, but on Sept. 14, longtime sales and marketing chief Joel Kocher quit the \$2.8 billion Austin (Tex.) company to become chief operating officer of Artisoft, a Tucson-based networking company. Known for passionate speeches and take-no-prisoners sales tactics, Kocher revved up Dell's phone-sales outfit. But when CEO Dell brought in Motorola veteran Morton Topfer as co-CEO in May to help bring order to Dell's operations, there was little room for Kocher. "Joel just couldn't go much further," says Dean Witter analyst Eugene Glazer.

Atlantic could lead to a deal by the end of September. The three would merge their cellular operations, creating a network slightly larger than that of market leader AT&T-MCI. If the talks fizzle, Sprint could still do a cellular deal with U.S. West and AirTel Communications. Sprint also is talking to John Malone Tele-Communications, among others, about bidding together on lucrative personal communication service licenses at the federal government's auction in December.

ET CETERA...

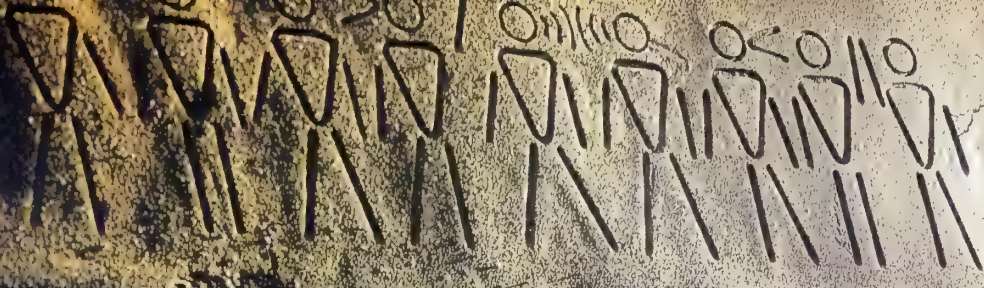
- Monsanto's stock jumped on news that President Robert Shapiro will become CEO.
- The National Academy of Sciences called for a \$2-per-pack cigarette tax.
- Microsoft is about to ship its new Windows NT networking software.
- A federal grand jury in Virginia indicted three former United Way officials.

CLOSING BELL



Talk about some fast dancing. Brazil's stock market skidded nearly 50% in dollars last spring, as Socialist Luís Inácio (Lula) da Silva took a lead over former Finance Minister Fernando Henrique Cardoso in the nation's presidential race. Since then, stocks have rallied 120%—and Cardoso has moved ahead—after the government unveiled a strict inflation and currency-reform plan and inflation fell to an eight-year monthly low of 1.4%. If Cardoso wins the election, scheduled for Oct. 3, he will have to keep the reforms coming to avoid another crash. A likely priority: privatizations.

DATA: BARING SECURITIES LTD.



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AT THE FED, SILENCE ISN'T GOLDEN ANYMORE

No one said *glasnost* would be easy for a hidebound, insular institution. Mikhail Gorbachev learned that the hard way. Federal Reserve Board Chairman Alan Greenspan and new Vice-Chairman Alan S. Blinder are taking their lumps, too, as they struggle to lead the Fed out of the financial shadows and into the light of scrutiny.

After operating for decades behind a veil of Kremlinlike secrecy, the central bank this year opened its bronze doors a crack. But the glare of openness is unnerving financial-market players used to being kept in the dark. The Fed's unprecedented announcement of a policy change in February sent Wall Street into a tizzy even though the bank raised interest rates a puny quarter of a point. In August, Blinder got his own dose of *glasnost* backlash when he admitted the obvious: Central banks balance inflation-fighting concerns against the impact of rate hikes on unemployment. His brief remarks unleashed a torrent of debate about the role of central banks.

HOW BLUNT? Despite the unease stirred by Greenspan's and Blinder's moves, the central bank won't return to its obscurantism. The regular announcement of interest-rate changes is now virtually standard procedure. But there's still vigorous debate within the policy-making Federal Open Market Committee about how much further to go. The Fed is announcing rates when there is unanimity, but it's afraid to disclose split decisions for fear the press will emphasize division. The FOMC is still deciding how blunt to be in explaining policy moves. And when rates went unchanged in July, the committee wouldn't announce nonaction. Dare it be bolder if it does something at its next meeting on Sept. 27?

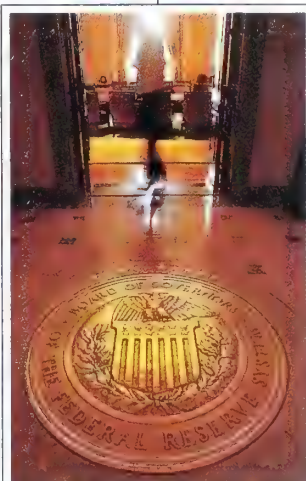
The opponents of big change at the Fed cite Blinder's woes as evidence. The Vice-Chairman's candor frightened traders who view the Fed as the bulwark against inflation. An open-

mouth policy, too, can turn small points into huge controversies, since the financial press is trained to find hidden meanings in cryptic Fedspeak. "More openness is a good thing, but you have to be careful you don't scare or surprise," says Darwin L. Beck, an economist at CS First Boston Corp. "Blinder got in trouble because he is suspected of being a closet inflationist."

Although Fed colleagues insist that Blinder's comments were innocuous—"The whole thing has been blown up way out of proportion," says Governor Lawrence B. Lindsey—they concede the flap reinforces their reticence about speaking out. Rather than be Blinder-sided, shrugs one Fed official, "My advice is to just shut up." But that kind of old thinking is what prompted outside critics—from Congress to Wall Street—to prod the Fed toward *glasnost*. The Fed is responding, but slowly and begrudgingly.

If anything, the Fed needs more prodding, such as to release FOMC meeting minutes promptly. The notes are now released five weeks later, but Wall Streeters see no reason to withhold them beyond a week. "The more information the Fed puts out and the more it explains monetary policy, the better," says Allen L. Sinai, chief economist at Lehman Brothers Global Economic Advisers Inc.

Fed officials still won't go public in a big way. Regular news conferences or appearances on the evening news shows—or C-SPAN—are out of the question for now. Still, there's no turning back from an overdue march toward greater accountability. An unrepentant Blinder seems determined to see to it. "The Fed could do a better job of explaining itself to the people," he argues. "It's their economy, not ours." Until Greenspan & Co. perfect the vocabulary of openness, however, look for more confusion in financial markets that can't read the new tea leaves.



THE FED: FINDING ITS VOICE

CAPITAL WRAPUP

REGULATION

Rupert Murdoch may not be off the hook quite yet with the Federal Communications Commission. Earlier this year, the FCC began probing allegations that Murdoch's Fox Broadcasting Co. had sidestepped rules limiting foreign ownership when it acquired several TV stations. At first, high-level insiders suggested that the matter would be swept under the rug. But the FCC staff isn't letting go; it's likely to find in October that Murdoch broke the rules after all. That would put the five commissioners on the spot. They could accept the finding and revoke Murdoch's licenses, jeopardizing the

emerging Fox network. Or the politically cautious FCC could ignore the staff, drop the matter, and watch *Beverly Hills 90210*.

THE WHITE HOUSE

He may not be a drawing card with voters, but President Clinton can attract well-heeled donors. That's why he'll be crisscrossing the country this fall to raise money for Democrats locked in tough election battles. Among those he's helping: California gubernatorial candidate Kathleen Brown, New York Governor Mario M. Cuomo, and Senators Edward M. Kennedy (Mass.), Frank R. Lautenberg (N.J.), and Charles S. Robb (Va.)

LAWYERS

Trial lawyers, who win favorable verdicts from Congress because of hefty campaign contributions, are extending their reach to state politicians. A new American Tort Reform Assn. study found that from 1990 to 1994, the lawyers gave \$20 million to candidates in California, Texas, and Alabama alone. Top contributors include San Diego-based securities class-action attorney William S. Lerach, who gave more than \$800,000 to state and federal candidates. The lawyers, who turn big profits from suing corporations, repeatedly have blocked moves in Congress to limit product-liability laws.

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RUSSIA

RUSSIA: 'THE FEARS ARE GONE'

To shore up stability, the U.S. is financing trade and investment



In the post-Soviet era, the dominant noise at U.S.-Russia summits has been the clink of the beggar's cup brandished by forlorn Moscow officials. The key policy question for the U.S. has been how much aid to offer a shaky regime. But when Russian leader Boris Yeltsin and President Bill Clinton got together in Washington on Sept. 27-28, a different sound will be heard: the soft rustle of new accords to promote trade and investments in a stabilizing Russia.

If all goes as planned, Clinton and Yeltsin will ink agreements to provide more than \$750 million in U.S. risk insurance, financing, and loan guarantees for American-Russian joint ventures in oil, aviation, and telecommunication (table). More government-backed deals will follow within weeks. The two leaders will also put their signatures on pacts expanding access to each other's markets. And the Clintonites are making sure Yeltsin has plenty of opportunities to hobnob with America's corporate elite.

The President will still endorse expanded global financial assistance to Russia and pledge to keep bilateral aid flowing, including a possible resumption of grain credits. But the thrust of the summit's agenda reflects the new priorities. "We're shifting from an aid-oriented strategy to one that brings the private sector more deeply into the picture," says a senior Administration official.

DELIVERING REFORM. To some extent, the new approach is making a virtue of necessity. Political support for generous dollops of Russian aid is fading. Congress cut \$50 million from the Administration's \$900 million request for fiscal 1995 assistance to the former Soviet republics. The revised total is far cry from the \$2.5 billion the U.S. ponied up this year.

The new focus on investment and trade is in keeping with broad Clinton foreign policy thinking. In the long run, Administration officials say, such measures yield a bigger bang for American taxpayer bucks than foreign aid. Says a White House aide: "We found that government [aid] is not the so-called answer to the problem." Boosting investment also creates jobs back home. That's because a high percentage of U.S. exports go to overseas subsidiaries of American companies.

In Russia's case, the new emphasis on trade is well-timed. The Russian economy seems to be righting itself after much turbulence.

**A U.S.-RUSSIAN
JOINT VENTURE:
DRILLING FOR
OIL IN SIBERIA**

oil. Inflation was down to a monthly rate of 4.6% in August, vs. 29% a year before. The nosedive in industrial production may be bottoming out. The incredible shrinking ruble has hovered around 1,000 to the dollar for several months. Economic reform continues apace. "They've devalued, and the performance has been quite positive," a top U.S. official says of Yeltsin and Prime Minister Viktor Chernomyrdin.

The brightening economic picture enhances Russia's chances of reeling in billions more in multilateral aid by year-end. Moscow and the International Monetary Fund have launched negotiations for \$4 billion in fresh loans. An expected IMF rule change could unlock as much as \$5 billion more in credits for Russia over the next two years.

THE VANGUARD. The good economic news is luring back foreign investors, too. Many were scared off by the stunning success of ultranationalists in last December's parliamentary elections. But now, says Russian privatization chief Anatoli Chubais, foreign investment is pouring in at a rate of \$500 million a month. The total foreign inflow for 1994 could top \$10 billion, well above earlier predictions of \$3 billion.

U.S. institutions and corporations want to be in the vanguard. At the summit, the U.S. Overseas Private Investment Corp. (OPIC) will announce that a Russia equity fund it partly underwrites is 20% oversubscribed. "The fears are gone," says Sarah Carey, a Washington attorney who heads Steptoe & Johnson's practice in former Soviet states. Carey says the size of deals her firm handles has jumped from less than \$1 million to as much as \$1 billion.

To prime the pump, Clinton will announce he is earmarking \$77 million of trade and investment aid for former Soviet republics, with Russia getting about \$50 million of that. While small, the amount will draw in many times as much in U.S. private investment. That's because loan guarantees, for example, can be leveraged up to support 10 times as much in commercial credits that would otherwise be unavailable. OPIC, which this year will provide \$2.3 billion in political-risk insurance, loans,



WHAT YELTSIN MAY TAKE HOME

The Overseas Private Investment Corp. is expected to finance more than \$750 million worth of U.S.-Russian deals, big and small. A few likely agreements:

TEXACO \$400 million to support Texaco's investment in the \$6 billion-plus Timan-Pechora oil development project

PRATT & WHITNEY \$250 million in insurance and financing for a \$300 million joint venture to design and build commercial aircraft engines

SFMT \$60 million loan guaranty to back the N.Y.-based company's plans to invest \$120 million in voice and data communications across Russia

MIDCOM \$23.5 million for the Seattle company to acquire a 50% stake in a Khabarovsk-based telecom company and expand its phone network throughout Russia's Far East

EAST WEST INVEST Unspecified amount of insurance to support network of Subway shop franchises and management training centers

DATA: OVERSEAS PRIVATE INVESTMENT CORP., BUSINESS WEEK

and guarantees for Russia, expects to do close to \$3 billion worth next year.

Within weeks of the summit, the U.S. Export-Import Bank expects to approve financing for \$500 million worth of American exports to Russia on top of \$1 billion in sales it has already backed this year. The bulk will underwrite exports of pumps, storage tanks, and other equipment needed to modernize Russia's antiquated oil-and-gas sector.

COLD WAR RELICS. The President will also pledge support for Russia's entry into the General Agreement on Tariffs & Trade and for legislation that will expand Russia's access to U.S. markets. Congress balked at the latter this year after affected industries registered complaints. To persuade lawmakers to reconsider, Clinton will press Yeltsin to lower tariffs on U.S. aviation equipment, autos, auto parts, and confectioner's sugar. Already, Boeing is set

to deliver two 767s to Aeroflot, the first such sale ever. Says an Administration official: "We have to be able to show them that the Russians are sensitive to our trade complaints."

Yeltsin, in turn, will lobby hard for a level playing field for trade and elimination of cold war relics such as the Jackson-Vanik Amendment, the 1974 legislation that denies Russia automatic most-favored-nation trade status. The Russian leader will also press for easing of export curbs on high-tech products such as optical fiber.

For example, U.S. West, Deutsche Bundespost Telekom, and France Telecom are about to proceed with a \$40 billion, 10-year project to upgrade Russia's phone system. But because of U.S. restrictions, a phone link spanning the country must rely on microwave rather than on fiber-optic transmissions. That's because it's easier for U.S. intelligence to monitor microwaves, says Oleg G. Belov, president of Rostelekom, the Russian partner in the deal.

SUMMIT BOOST. The need to beef up Russia's own export controls will figure prominently in the summit's political and security sessions. Clinton will offer a multilateral package of initiatives to safeguard Russian plutonium and other fissile materials. The plan involves training Russian customs officials and other technical support. Clinton will also urge Yeltsin to put pressure on Bosnia's Serbs to accept a negotiated settlement of their bloody civil war with Muslims in the former Yugoslavia.

Clearly, however, the emphasis will be on the upbeat. Given the widespread public opposition to a possible invasion of Haiti as well as continuing doubts about his grip on foreign policy generally, Clinton badly needs the fillip that U.S.-Russia summits often provide. The President's unwavering backing of Yeltsin and other Russian reformers has been vindicated so far. Stepping up support for trade and investment ties will make this rare foreign policy victory even sweeter.

By Amy Borrus in Washington and Peter Galuszka in Moscow, with Paula Dwyer in London

BIG BLUE WANTS THE WORLD TO KNOW WHO'S BOSS

But wresting autonomy from its country fiefdoms is no easy task

On the crisp, sunny morning of Sept. 7, Lucio Stanca, the new chief of IBM Europe, greeted his top 100 managers in the basement of the company's Paris headquarters. The 52-year-old Italian promised to give all his "energy and passion" to speeding change. Between the lines, the message was clear: Anyone who lags behind just might be left there.

Following the abrupt departure of IBM Europe chief Hans-Olaf Henkel, Stanca and his top executives at the Paris operation are now racing to implement Chief Executive Louis V. Gerstner Jr.'s vision of a more nimble global company. Deadlines to create a new management organization are being pushed forward and efforts to think global redoubled. Henkel's departure "is a signal to everyone and especially his successor," says Martin Oertel, computer systems and client-server industry analyst at market researcher Dataquest in Britain.

Insiders say Henkel fell out with Gerstner over his reorganization efforts, which are designed to shift power from country managers to the heads of 14 new industry sectors. Impatient for change, Gerstner has bet his credibility on IBM's swift turnaround. "He has no consideration for anyone who is not 100% on his side," says Oertel.

"NOT MOTIVATING." But the rush to change is creating friction at the top levels of the computer giant. By adopting a shock-therapy approach to IBM Europe's transformation from a checkerboard of competing fiefdoms to a more streamlined, global organization, Gerstner may be risking major internal dislocation. Country managers have been bypassed for new pan-European posts. Top managers who once formulated strategy now find themselves playing the role of local IBM "ambassador"—coddling clients, tending to small businesses, and preening IBM's image. The new setup has "enormously reduced the role of someone managing a country or a region," says a former senior executive at IBM Europe who left the company recently. "It's not motivating at all."

Stanca's first job will be to



STANCA: IBM'S POINT MAN IN EUROPE

assuage wounded egos and get IBM's troops marching together. "The biggest challenge is getting everyone sorted out and creating a new mind-set," says Robert Dies, an executive vice-president at IBM Europe.

No doubt IBM needs a streamlined global structure. But analysts warn that

changing too much at once could backfire, at least short-term. Rivals have changed more gradually and avoided management tumult. Hewlett-Packard Co., for example, gave country managers dual roles instead of demoting them. "When you talk about human nature discontinuities are not good," says Brun Didier, marketing vice-president for Compaq Computer Corp. in Europe.

TEAMWORK. There's no way IBM can avoid a serious shakeup, though. The old model of doing business—local operations complete with a chairman and board, financial staff, sales force, a full complement of technical experts, an unquestionable say over all aspects of the company—is passé. Now a debilitated Big Blue, struggling to control costs and cater to a global clientele, needs to serve its markets across industry groups and regions. That means breaking down its once sacrosanct national boundaries.

It also means shifting clout from country managers to the centralized group of experts, each focused on a key region of the world. Dies says 70% to 80% of IBM Europe's business will be handled by new industry sector teams. The teams are expected to be named within the next six weeks and may be operating before the Jan. 1 target. "We're making progress faster than anticipated," says Dies. "IBM is lighter on its feet than most people give it credit for."

The main goal of the remake is to globalize control over product development, sales, and marketing. Before multinationals found it impossible to do business with IBM as a single entity. Now a single contract could cover the world. "Getting a global buying arrangement remains one of the hardest problems," says William R. Hoover, chairman of Computer Sciences Corp., an IBM customer.

One reason for Gerstner's sense of urgency is to improve IBM's overseas performance. Last year, European revenues fell 12.8%, to \$21.85 billion. Europe showed a profit on operations of \$71 million but posted a net loss of \$1.7 billion as a result of charges for restructuring. In Japan, IBM lost \$240 million on sales of \$12.6 billion. So far this year, both regions are up (chart), but efforts to cut expenses abroad lag those in the U.S. Gerstner's new team in Europe says he has left the execution up to them. They'll need Stanca's passion—and more—to make it work.

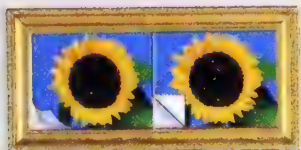
By Ira Sager in New York and Gail Edmondson in Paris, with bureau reports

WHERE THE GROWTH IS

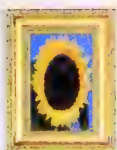
IBM revenues	1st quarter		2nd quarter	
	Billions	Year to year percent change	Billions	Year to year percent change
U.S.*	\$5.3	6%	\$5.9	0%
CANADA	0.5	-2	0.6	13
EUROPE/MIDDLE EAST/AFRICA	4.7	3	5.5	0
ASIA PACIFIC	2.3	13	2.8	14
LATIN AMERICA	0.6	14	0.6	0
TOTAL	\$13.4	6%	\$15.4	3%

*Adjusted for sale of Federal Systems Division

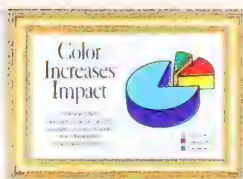
DATA: COMPANY REPORTS



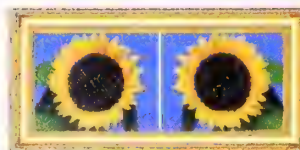
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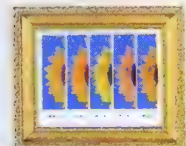
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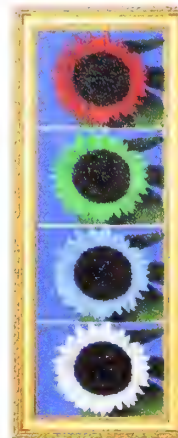
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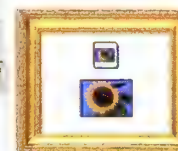
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WHY THE QUEBEC VOTE WAS PRELUDE, NOT PROLOGUE

Supporters of Canadian unity are almost euphoric following the unexpectedly narrow victory of the nationalist Parti Québécois in Quebec's Sept. 12 elections. While the PQ captured 77 of the 125 seats in the Quebec National Assembly, it finished in a virtual dead heat with the ruling Liberal Party in the popular vote. The outcome boosted the Canadian dollar to a six-month high. And it led Prime Minister Jean Chrétien to confidently predict that "Canada is here to stay," despite the PQ's vow to make Quebec independent.

But much of the positive spin may simply be wishful thinking. Canada may be in for the most brutal trial in its 127-year history as PQ leader Jacques Parizeau follows through on his pledge to once again put Quebec independence up to a popular referendum. The debate will spill over into English Canada, get very nasty, and leave permanent scars—even if the referendum is defeated.

Voting it down is far from a sure thing. While polls show that only 40% of Quebecers back independence, the referendum battle is just beginning, and the PQ has never been in a stronger position. While the PQ has been elected twice before, never has it been so dominated by hard-line separatists.

WIDENING POLARIZATION. Despite the close popular vote, the separatists will command a 30-seat majority in the National Assembly, giving them enormous power to make the case for sovereignty. At the same time, the PQ's federal wing, the Bloc Québécois, will be advancing the separatist cause on the national stage in Ottawa. With all this, "I don't think there's any question they have a chance to win the referendum," worries Michael Walker, president of the Vancouver-based Fraser Institute—a think tank.

In contrast, the federalists are in a far weaker position than in 1980, when the first referendum on Quebec indepen-

dence was defeated. In 1980, English Canadians set up committees to tell Quebecers how much they were loved, and then Prime Minister Pierre Trudeau made big compromises to meet Quebec's demands for more autonomy. That was critical to turning the tide against the referendum. But today, with Quebec and English Canada far more polarized, Chrétien can't offer such concessions.

BLUNT WORDS. That's because over the past four years, English Canada has rejected two efforts to revise the Canadian Constitution to meet Quebec's demands. This time, as British Columbia Premier Michael Harcourt said recently, English Canada will be telling Quebec: "You're in or you're out."

In this environment, the PQ leadership "will do what they can to offend English Canadians," predicts pollster Angus Reid. They are already threatening to boycott Chrétien's effort to overhaul Canada's social-welfare programs, a quest as important to him as health-care reform is to President Clinton. But if the Quebecers get tough, English-speaking politicians may retaliate by calling for a drastic cut in the size of an eventually independent Quebec.

The battle looming is nightmarish for business leaders, who fear that uncertainty will poison their operating environment. That's why the Conseil du Patronat, an association of Quebec's major employers, is already urging the PQ to get the referendum out of the way within the next 8 to 10 months. Give the close Sept. 12 election returns, however, the PQ is now far more likely to delay the referendum until late 1995, giving the party more time to campaign. Even if it goes down to defeat, Quebec and all of Canada are in for a rough ride until then.

By William C. Symonds in Toronto



GLOBAL WRAPUP

KOHL CAN'T BREATHE EASIER

Helmut Kohl's strong recovery in the polls puts him close to winning a fourth term as German Chancellor in Oct. 16 federal elections. But he's not a shoo-in. The chronic weakness of his coalition partner, the Free Democratic Party (FDP), could still sabotage his bid.

In its latest electoral setback, the FDP was ousted from the east German state parliaments of Saxony and Brandenburg in Sept. 11 contests, gaining only about 2% of the votes. If the FDP doesn't make the 5% cutoff for Bundestag representation, Kohl might well fall short of a majority. If so, he might

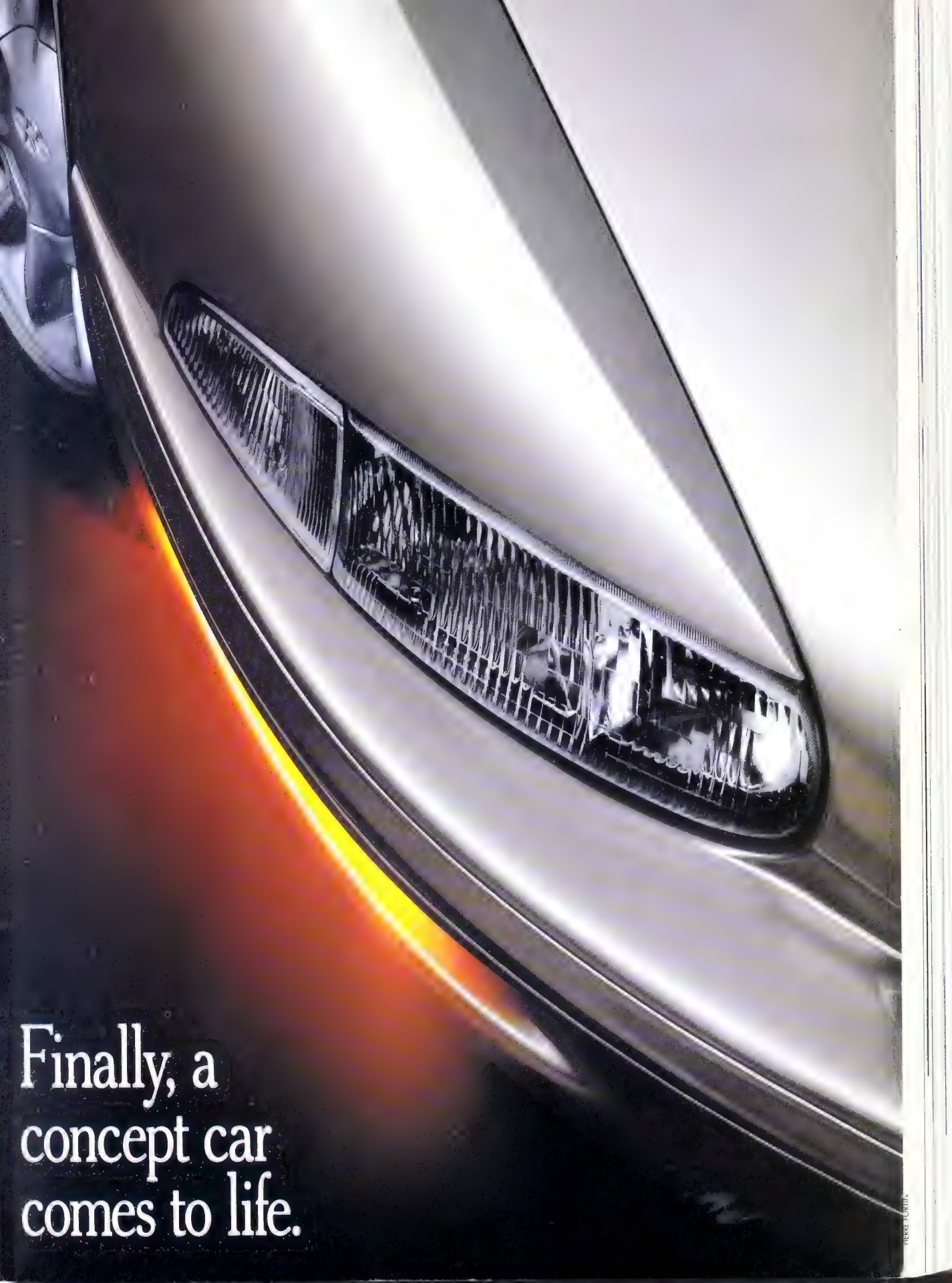
be forced into a coalition with the opposition Social Democrats—an outcome he has said he would not accept.

AN UNTIMELY EXIT FROM JAPAN

The Cleveland-based design and engineering company Austin Co. has closed its Tokyo office, possibly hurting the U.S. effort to pry open the protected Japanese construction market. Austin, one of the pioneers in Japan, says that it is responding to a poor business climate for American companies but will continue to pursue Japanese projects. Still, the move could strengthen the Japanese government's argument that U.S. companies lack commitment.

WILL VIETNAM STOP THE BUCK?

The Vietnamese government is about to launch what could be a futile war against the dollar. As of Oct. 1, Vietnamese businesses will be required to convert the majority of their foreign-exchange earnings into the local currency, the dong. It will be hard to make the order stick. The dollar is now demanded by the gamut of businesses ranging from government-sponsored enterprises to street peddlers. There is little confidence in the traditionally unstable dong. Also, at 10,900 dong per dollar, people have to lug around huge bundles of cash to complete transactions.



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HOW BUSINESS IS LINKING HANDS IN THE INNER CITIES

Partnership with local groups is helping make philanthropy work

Banks and inner cities have had a history of troubled relations, and Huntington Bancshares Inc., based in Columbus, Ohio, was no exception. Under pressure to increase its minority loans, Huntington tried advertising to inner-city neighborhoods. But the campaign, says Donald Walters, senior vice-president for community services, "wasn't working." Local blacks such as Phillip Douglas say the bank was insensitive to their needs. Walters, on the other hand, says the communities "didn't trust" his bank or any other institution.

Then, Paul R. Taylor entered the picture. In 1991, the Columbus community development consultant with longstanding ties to the bank proposed a smart strategy: get the minorities and bank together through a partner they both respected—the churches. Through Taylor's firm, P.T. Associates, Huntington tailored a pack-

age of services for inner-city residents and used its marketing budget to make a set donation to the churches for every customer they signed up. The bank has booked \$44 million in mortgages—at market rates—and some of the 165 participating churches are earning up to \$1,000 a month. Taylor is replicating the program in seven other states. "Everybody knew it was a win-win process with the church involved," says Douglas. "The church eased people's fears and skepticism."

MOVING ON. By joining with the church to gain a foothold in the inner city, Huntington is part of a growing trend. Not long ago, most companies avoided doing business in inner cities or getting mired in their problems through corporate philanthropy programs. Those that got involved often walked away frustrated, either because they tackled isolated issues or ignored the residents' most pressing

needs. "Their attitudes were, 'This is too overwhelming, we'll just move out,'" says Charles R. Stephens of the Center on Philanthropy.

Haunted by memories of the Los Angeles riots and never more aware of such entrenched urban problems as crime and illiteracy, companies are turning to the cities. Unlike in past efforts, Corporate America isn't trying to impose its own solutions. From General Mills Inc. to Lincoln National Corp., companies are helping to rebuild entire neighborhoods—and they are doing so in partnership with the communities.

Good public relations is only one factor driving such efforts. Companies such as Pathmark Stores Inc. and J. P. Morgan & Co.'s community development arm are targeting inner cities as profit centers and rebuilding communities at the same

time. Others such as Textron Inc. and the St. Paul Cos. are refocusing their philanthropic goals, funding or teaming up with local groups to take on many problems simultaneously. "There's more going on," says Paul S. Grogan, president of the Local Initiatives Support Corp. (LISC), which funnels private funds to communities. "And more companies are participating in more than one way."

The surge of corporate-community partnerships is gaining notice. The Committee for Economic Development (CED) has been studying some of the most promising projects, such as the development of a shopping center anchored by a Pathmark supermarket in Newark, N.J., through a joint venture between Pathmark and nonprofit New Community Corp. The CED is readying a report urging business leaders to make the reversal of urban decay a top priority in partnership with residents or through LISC and similar intermediaries. "The only fundamental, lasting solution to inner-city problems has to be built on the residents," says William S. Edgerly, a former bank CEO who chairs the CED task force on inner cities.

The Conference Board, meantime, in a coming report reviewed by BUSINESS WEEK, assesses the risks in a variety of community partnerships as a guide for

TACKLING TROUBLED INNER CITIES

SOURCE: CONFERENCE BOARD, BUSINESS WEEK

DIRECT INVOLVEMENT

Hallmark, General Mills, and other companies are seeking to revive neighborhoods, fix schools, and curb violence.

Risks: Even with long-term commitment, odds for success are iffy.

PARTNERSHIPS WITH COMMUNITY GROUPS

With the help of these groups, Pathmark Stores and others are entering inner-city markets and rebuilding neighborhoods.

Risks: A lack of mutual trust and openness will doom projects.

COMMUNITY INTERMEDIARIES

Companies are investing in cities through entities such as the Local Initiatives Support Corp. that funnel private funds to communities.

Risks: The intermediaries will add bureaucracy, not build bridges.

capability: executive programs

THE NIMBLE GIANTS



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Chairman, U.S. Joint
Chiefs of Staff
(1989-1993)



John F. Welch
Chairman and Chief
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Source: Morgan Stanley Capital International and International Finance Corp., 1994.

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Social Issues

companies contemplating such projects (table, page 81). The report concludes that companies, while they can't replace government or community groups, have found they can bring "special capacities to a partnership." But it warns that community building requires a long-term commitment of a decade, and even then, chances for success are iffy. What's more, the projects tend to be high profile and to become entangled in political brawls.

LOTS OF PRAISE. The Atlanta Project is a prime example. Launched as a private community development umbrella agency by former President Jimmy Carter in 1992, the Conference Board calls it "one of the most ambitious community projects ever taken on by the corporate sector." The Atlanta Project divides the city into 20 "clusters." Each cluster has a corporate partner that agreed to commit an executive for five years, plus donate funds and services. Companies signing on include Equifax, Coca-Cola, and Sprint. Some \$32 million in cash and kind has been contributed to the project, but it isn't a relief agency: Its key role is to help communities solve their own problems in six main areas: community development, economic development, housing, education, health, and public safety.

The program has won plaudits nationwide, but all has not gone smoothly. "We've had tremendous problems and frictions," says Daniel E. Sweat, program director. In one cluster on the city's rough east side, political turmoil over how to divvy funds has left sponsor Atlanta Gas Light Co. trying to referee among warring factions. "If there's more than one group vying for power, it's very difficult for them to develop a plan for their community," Sweat says.

Other partnerships have been more harmonious. San Antonio's United Services Automobile Assn., an insurance and financial services company, conducts its philanthropic activities in inner cities mostly through community-based non-profits. USAA's banking unit, for example, is the main corporate funder of the Neighborhood Housing Services of San Antonio Inc., an affordable-housing group. A USAA assistant vice-president is chairman of the NHS and sits on some committees. Still, the NHS and the communities set the agenda. "This is a true joint venture, but the residents let us know what they need," says the NHS's Greg Frazer. "They are the experts in their neighborhoods." If companies keep that in mind, and if they're willing to make the commitment, the future of corporate-community partnerships is bright.

By Michele Galen in New York, with David Greising in Atlanta and Stephanie Anderson Forest in Dallas

BIOTECH

AN INDUSTRY CROWDED WITH PLAYERS FACES AN UGLY RECKONING

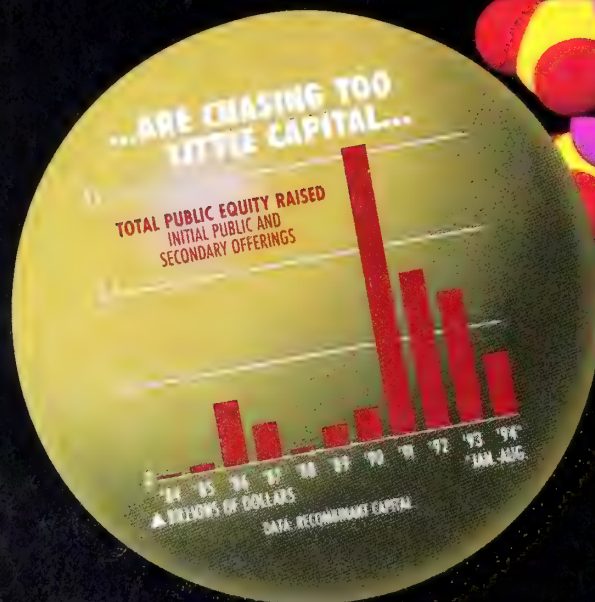
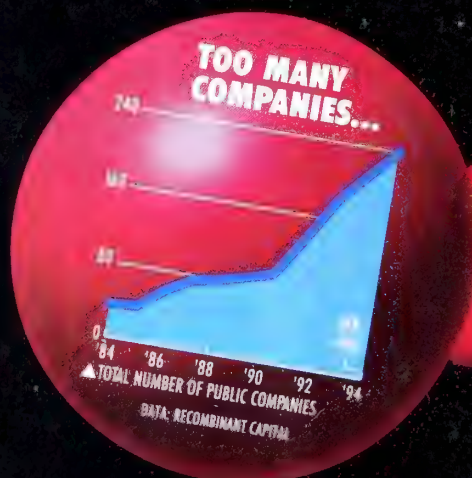
*Those were the days my friend,
We thought they'd never end.
We'd clone a gene and form a company.
We'd raise some venture cash
And do our IPO in a flash.
'Cause selling dreams
Requires no p-e.*

Biotech investment pro Richard M. Beleson of Capital Research Co. has entertained industry executives for years with his satirical songs. And this chorus from his recent *Biotech Bear Market Ballad* is particularly apt: Nearly 20 years into the gene-splicing revolution, the industry has ballooned to well over 1,000 public or private companies that have raised about \$20 billion. Yet no one has cured cancer or produced a bioengineered miracle of loaves and fishes for a hungry Third World.

The industry is still peddling dreams, and it did raise \$4.7 billion in public and private capital in the 12 months ended last June. But investors are getting leery, and the money flow is drying up. Except for a handful of top-tier companies with proven products, biotech stocks have plunged: The Amex Biotech Index is off more than 50% from its zenith in 1992. Ernst & Young estimates that only 50% of all biotech hopefuls have enough money to last 24 months, and most of those are still years from having a product. After a giddy run in the early '90s, "the market is disillusioned" with biotech, declares Karen Firestone, who manages Fidelity Investments' \$500 million Select Biotechnology Fund. From Wall Street's perspective, "the technology hasn't worked, and the likelihood of success is lower."

After a decade as the highest-flying of America's high-tech industries, biotech faces a reckoning—and it's going to be ugly. The billions in investment have created an industry choked with copycat, capital-hungry companies lacking the critical mass of technology to survive. The vision that industry backers had of

THE SAGGING FORTUNES OF BIOTECH



path to riches no longer holds sway: biotechnology, while immensely valuable, is not the shortcut to success in the drug game its advocates once thought it would be.

Instead, the industry has been hampered by uneven management, driven to lure new investment and in companies that have little prospect of succeeding, and wracked by product failures. Even if the market warms up again, consolidation is inevitable. "Seventy percent of these companies need to go out of business," argues Lisa B. Tucker-

ABOUT HALF OF THE COMPANIES HAVE ONLY ENOUGH MONEY TO LAST TWO YEARS

man, who from her Montana base analyzes biotech for the New York investment management fund at Spears, Benzak, Salomon & Farrell. More and more executives in an industry renowned for its optimism agree. The best of the technology will survive, but primarily inside

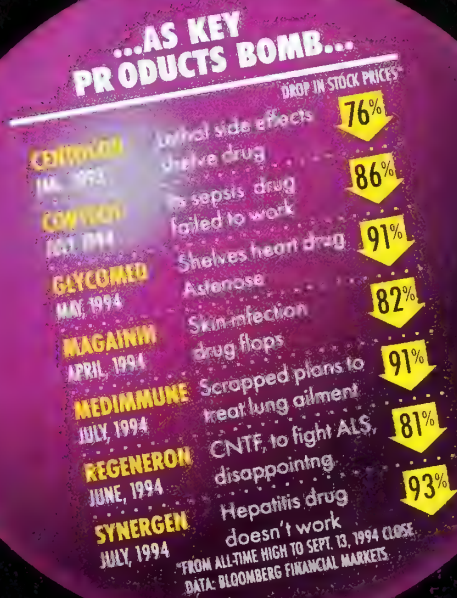
large drugmakers, not in an independent industry. "Nobody's going to make it alone," contends Genentech Chief Executive G. Kirk Raab, who came to that realization in 1990, when he sold 60% of his company to Roche Holdings Ltd.

Such talk was heresy just three years ago, when investors were enthralled with biotech. They showered the industry with \$8 billion in public and private capital from 1991 to 1992. Aided by low returns from rival investments, by Amgen Inc.'s roaring success, and by a wealth of new technologies, the stock of almost any company with "gen," "cell," or "immune" in its name went one way: up. Venture capitalists, flush from almost 90 initial public offerings in those years, pumped out still more startups.

Yet investors were sowing the seeds of a future crisis. Biotech companies generally need 7 to 10 years and \$100 million to \$150 million to bring a new drug to market. During the 1991 bio-bull run, most newly public companies—plus older ones teetering on the brink—raised about three years' worth of money. Barring spectacular progress, chances were slim to none that the market would pony up as much or more money when that grubstake ran out. After all, to support even 50 companies with 50 products from lab to market would require at least \$5 billion in total capital. And instead of great advances, in recent months the industry has produced high-profile product failures (chart).

NOTABLE SUCCESSES. Momentarily, at least, those gaffes have obscured biotech's stunning contributions. When venture capitalist Brook H. Byers of Kleiner Perkins Caufield & Byers (KPC&B) says that biotech has been "for human biology what the Italian Renaissance was for art," he isn't indulging in hyperbole. The technology has brought a vast array of techniques and tools to drug development and medical research. Today, "every pharmaceutical company is heavily involved in biotechnology," says Stephen K. Carter, senior vice-president for worldwide affairs at Bristol-Myers Squibb Co. And even when the final product is a traditional, chemical drug, increasingly, biotech will have played a role in testing the agent or providing insight into the disease it aims to fight.

As for products, biotech's list is short but impressive: Of the 24 top-selling drugs worldwide, 4 are derived from biotech. One of Schering-Plough Corp.'s best-sellers is alpha interferon, a \$500 million-a-year product that it licensed from gene-splicer Biogen Inc. in Cambridge, Mass. The blockbusters that have emerged from Amgen—EPO to bat-



the anemia and G-CSF to fight infections in immune-suppressed patients—have turned the Thousand Oaks (Calif.) biotech pioneer into a cash machine: Amgen is generating \$110 million in cash per quarter, even after plowing 19% of its \$1.5 billion in annual revenues into research and development.

Thanks to biotech, too, fewer people die of heart attacks today because of Genentech's blood-clot-busting TPA. And that company's Pulmozyme makes breathing easier for cystic fibrosis patients, including Kimberly Myers of Half Moon Bay, Calif. By helping clear her lungs, she says, Pulmozyme gives her "the ability to stay out of the hospital and do more," such as concentrating on her career as a race-car driver. Millions of tests each year for everything from ovulation to AIDS are based on biotechnology. Meantime, a million or more people may have avoided getting hepatitis because of genetically engineered vaccines and blood-screening tools.

FALSE HOPE. Lab wizards also are unraveling what the 100,000 or so human genes do, promising eventual cures for diseases from cancer to rare genetic disorders. And as large drugmakers struggle to reenergize moribund antibiotic research, biotech outfits are at the forefront in fighting antibiotic-resistant bacteria. "There is tremendous innovation, and the accelerating pace of the science is incredible," says Dr. Janet Woodcock, director of the Food & Drug Administration's Center for Drug Evaluation & Research. "It's almost impossible to believe that the investment being put in is not going to pay off."

With ordinarily dispassionate regulators talking like that, why are industry executives singing "those were the days"? Because recent product-development setbacks have challenged an assumption upon which the financial structure of the industry was based—that by creating a more efficient path to new drugs, biotech entrepreneurs would take over the pharmaceutical business.

In 1976, when venture capitalist Robert A. Swanson and scientist Herbert Boyer formed Genentech, most large drugmakers were randomly screening thousands of chemicals each year looking for the drug equivalent of the needle in the hay-



"The technology hasn't worked, and the likelihood of success is lower"

KAREN FIRESTONE
Portfolio Manager,
Fidelity Select Biotechnology Fund

stack. Scientists knew that the body has its own storehouse of proteins that carry out important functions such as lowering blood pressure or fighting infection. Genes are nature's recipe for manufacturing those chemicals. So when Boyer and colleague Stanley Cohen found a way to slip a gene into cells that could then churn out huge quantities of the desired protein, it seemed like the perfect way to make great drugs—not just find them.

This approach worked for the pioneers. Drugs such as gene-spliced insulin, growth hormone, and the anemia-fighter erythropoietin had few side effects and moved efficiently through regulatory channels. In hindsight, though, those treatments, which replace well-understood substances the body manufactures, were easy

targets. When companies pursued more complex viruses, such as cancer, heart disease, and neurological disorders, all bets were off. Often, animal tests don't indicate how humans will respond to drugs for such diseases. And deciding just what protein would make a drug might mean picking through thousands.

Sepsis is a good example of the challenge. If you are severely burned or injured or have late-stage cancer, there's a decent chance you'll join the 600,000 Americans who develop sepsis each year. It's a massive infection that floods the bloodstream with toxins, leading to shock and, for 100,000 patients a year, death. The U.S. health care system spends \$10 billion annually treating these people. That sounded like a great market to Xoma, Cencor, Cortech, Chiron, and Synergen, which poured hundreds of millions into research on sepsis drugs. But they all failed. Sepsis, it turns out, is more complex than once thought: It involves a chemical cascade of events that can't be easily altered by a single drug.

AIDS research swamped other companies. Biotech tools have improved understanding of the disease, but the industry has yet to produce vaccines or effective

SOME BIOTECH WINNERS...

Company Product	1993 Revenues Millions	Earnings Millions	Stock
AMGEN EPO to fight anemia; Neupogen, an immune stimulator	\$1,500	\$383.3	5
BIODON Alpha interferon for hepatitis and cancer, Hepatitis B vaccine (both licensed); diagnostic technology	\$149.3	\$32.4	5
CHIRON Hepatitis tests (licensed to Ortho); Interleukin-2, an anticancer agent; Betaseron, multiple sclerosis drug	\$317	\$32.4	6
GENENTECH Human growth hormone; TPA for heart attacks; Gamma interferon for a childhood immune disorder; DNAase for cystic fibrosis	\$649.7	\$58.9	50
GENZYME Ceredase and Cerezyme for Gaucher's disease	\$274	-\$6	3

*65% owned by Roche Holdings Ltd

tments. Biogen, Genentech, and Immune Response all suffered expensive setbacks in AIDS programs. As the challenges have become more daunting, the industry has splintered into narrower segments. Some companies, such as Cor Therapeutics Inc. and Cephalon, target specific diseases such as cardiovascular and neurological problems. Others specialize in technology. So-called antisense companies work with strands of RNA to try to block the function of deleterious genes. Others are unraveling how cells communicate with one another. And more than two dozen companies are racing to deliver genes to treat everything from genetic disorders to cancer (page 92) even though that field is rife with failures from a product.

IDEA OUTFITS. The trouble with many of these are one-product companies. "A clustering of six ideas that could be one solid company inevitably turns into six companies," says Cor Therapeutics' Vaughn M. Kailian. And many of these startups have no resources to do the biopharmacology, physiology, and other research needed to succeed.

That helps explain why most of the drugs that biotech companies have put into clinical trials aren't working. Biotech analyst Sarah Gordon-Wilde at Amerin-



"Seventy percent of these companies need to go out of business"

LISA TUCKERMAN
Analyst,
Spears, Benzak, Solomon & Farrell

do Investment Advisors Inc. says that only about 10% of biotech drugs that enter clinical trials and about 50% of the drugs that proceed through the final level of testing may get approved—the same as for traditional chemical drugs.

"The industry was valued so high and had such a premium because it was believed biotechnology would have a much higher 'hit rate,'" she says. Unless startups have an efficiency edge over better-funded drugmakers, they have got to be preternaturally lucky to stay alive.

Look at Synergen. In 1991, the Boulder (Colo.) company was sitting on \$300 million in capital. It was developing Antril, an antiseptic drug that some analysts believed could be a billion-dollar blockbuster, and its stock zoomed to a high of

\$75. Management exemplified the hubris for which biotech execs are legendary: When a Wall Street analyst criticized the company, Chairman Larry Soll sent him a package containing a tin of Shinola shoe polish and a gag-store pile of plastic dog poop, with a note suggesting the analyst couldn't tell the difference.

Not long after, however, Synergen revealed that its test results showed that Antril did not work as well as expected, although the company thought it showed promise for some patients. The board forged ahead anyway, building a manufacturing plant, hiring a sales force, and pushing Antril into another phase of more expensive tests. Synergen had blown through \$165 million by the time it announced in July that it had stopped testing because the drug wasn't working. Management axed 60% of the workforce and is trying to find buyers for what remains of the company, say former Synergen executives. And Soll? He has told colleagues he wants to open a coffee shop in the San Juan Islands. The company

declined requests for interviews.

The Synergen debacle underscores a major problem: The intense pressure to please investors and raise more R&D funds, some charge, is prompting unwise decisions on how soon and how thoroughly to test potential drugs. By the time Antril showed poorly in its first big trial, for example, evidence was building that sepsis might be too complex to treat with one agent. Other companies with failures, including Regeneron Pharmaceuticals Inc. and Magainin Pharmaceuticals Inc., have also been chided for not adequately evaluating agents earlier in the process and for rushing too quickly into big, expensive tests.

RUSH JOB. "Shortcuts are the longest road in this business," warns Raab of Genentech. He believes products should be taken into large trials only after intense attention to smaller, thorough tests. He concedes that Genentech rushed some of its earlier trials with its clot-busting heart drug TPA. That's one reason it had to spend \$50 million on subsequent tests after the drug was approved to show it saved marginally more lives than competing agents.

Who's to blame for creating this financial Jurassic Park, where the bio-creatures reproduced too quickly and now

...AND SOME TO WATCH

Products move forward, analysts predict the industry could not, biotech stocks will drop more. Look for news on these...

TERAPEUTICS Conducting pivotal trials on *Integrelin*, which disorders that follow heart attacks

Testing *Beta interferon* to slow progress of multiple sclerosis

OR Awaiting approval of *ReoPro* to prevent blood clots

Completing key tests on *Betakine* to treat macular holes, a condition of the eye that leads to blindness

ME Testing *Thyrogen* as a treatment for thyroid cancer and *nicotinic acid* as a product for surgical adhesions

AMERICAN VACCINE Awaiting key data on a new vaccine for diseases such as whooping cough

Awaiting approval for wound-healing product

D Awaiting approval on a cell-separation system to aid in bone transplants

Awaiting approval on *WinRho*, a potential blood-disorder treatment

DATA: COMPANIES, BUSINESS WEEK, FIDELITY INVESTMENTS

Cover Story

fight for survival? Start with venture capitalists, the same folks who get the credit for getting the industry off the ground. "Returns have been disproportionately high for the venture capitalists and disproportionately low for the public," observes G. Steven Burrill of the San Francisco biotech merchant bank Burrill & Craves. By getting in early, then mostly cashing out when

companies go public, the venture capitalists succeed even if companies don't. The big returns they collected from IPOs let them attract still more capital. The result: Even as existing companies faltered, they kept starting new ones.

Venture capitalists say that mentality is changing. In recent months, they've formed far fewer companies. And some have even started to invest more in lat-

er-stage, public outfits. Brook H. Bye, whose firm has started 50 life science companies since 1976, maintains the venture capitalists didn't conspire to overload the industry. "We've trained ourselves as decision makers and judges of quality" on a deal-by-deal basis, says. More to the point, he insists that KPC&B tells 80% of the entrepreneurs seeking funding that they would be b-

WARNING: DON'T INVEST IF YOU HAVE HEART PROBLEMS

When Hambrecht & Quist President Daniel H. Case III recently wrote a missive to his clients on opportunities in biotech, he titled it: "now is the time to bet on biotechnology stocks." He wasn't aping e. e. cummings: He meant for the lower-case letters to signal the caution he feels. Indeed, given the negative investor psychology about biotech right now, even seasoned pros are nervous about advising clients to go near the industry.

With so many issues at all-time lows and some companies trading near or below the value of cash they have in the bank, the old saw about buying low and selling high would seem to make now the time to jump in. Yet fear of widespread failures is pervasive and the fundamentals of these still mostly productless companies are hard to measure. "You can buy at four and be at zero in two years," warns Karen Firestone, who runs the nation's largest biotech-only fund at Fidelity Investments.

That fact is prompting an investor flight to quality. PaineWebber Inc.'s Linda I. Miller says the best investment during consolidation is a basket of "large companies with successful commercial activities or visible product pipelines, including Amgen, Biogen, Chiron, and Genentech."

The stock of Amgen, for instance, has remained strong partly because it has two blockbuster products generating heady profits and partly because it has moved up on takeover rumors in recent weeks. Chief Executive Gordon M. Binder says the company isn't interested in being acquired. In fact, the board is so confident of Amgen's potential that it has spent \$443 million since 1992 to buy back stock. That's hardly a ringing endorsement of the strategy some major biotech companies are fol-

lowing—of investing aggressively in alliances and the equity of smaller players. Insists Binder: "Amgen's stock is more attractive ... than the great majority of them."

Genentech, meanwhile, is a bit of an arbitrage play: It is 65% owned by Roche Holdings Ltd., which has an option that expires in 1995 to buy out the rest of Genentech for \$60 a share. That has worked to stabilize the stock, now trading at around 50. The question is



CEO Binder:
His board is so confident of Amgen's potential that it has spent \$443 million buying back stock

whether Roche will buy the rest or renegotiate and extend the deal. Genentech CEO G. Kirk Raab says he doesn't know what Roche is planning but says the arm's-length posture the companies have maintained has worked well to keep an entrepreneurial spirit alive at the South San Francisco gene-splicer.

STOCK-PICKING TIPS FOR BIO-INVESTORS

- ▶ To play it safe, stick with top-tier companies
- ▶ Look for good science and enough cash to last
- ▶ Hedge bets via biotech sector mutual funds
- ▶ Some new investment vehicles such as "vanishing preferred" stock mitigate downside risk

Analyzing the prospects of the majority of 200-plus public companies that don't even have products to sell yet can be more daunting. Capitol Research analyst Richard Beleson sees an impending "Darwinian struggle for capital. Presumably, the best ideas will outcompete the others." Based on that assumption, Case of Hambrecht & Quist Inc. provides tips for "careful, brave, and discerning" biotech foragers.

■ Look at companies with good science and enough cash to last for several years at current burn rates. It's hard to ascertain the former, although brokerage houses provide some analyses, and industry newsletters such as *BioVenture View*, *BioCentury*, and the *Medical Technology Stock Letter* cover individual companies' progress.

■ Spread risk by investing through dedicated life-science and closed-end mutual funds. If you belong to the camp that believes the cycle will inevitably put biotech back in favor, such funds as H&Q's Life Sciences Investors (or Fidelity's Biotechnology Select fund) are run by seasoned industry hands who are buying "baskets" of promising stocks to better spread risk.

■ Check out incentives some promising but undercapitalized companies are offering, such as "vanishing preferred," which attract investors by offering a higher preference than common stockholders get in the event of a liquidation. The preference goes away when the shares are sold. At that point, they become common stock.

Unfortunately, with so many companies to choose from, hardly any of them with real sales or earning fundamentals to assess, urging potential investors to "selectively buy" is almost no advice at all. So forget cummings. BUYER BEWARE.

By Joan O'C. Hamilton

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ter off merging with an existing outfit or selling their technology. Venture capitalists aren't the only ones who got carried away. Universities looking for income from patents and licensing deals encouraged their scientists to form companies—and those researchers, wanting to run their own shows, resisted selling their discoveries.

FREE PLUG. Investment banks also played a role in this greed-fest. Binging on fat fees during the bull market, they had little incentive to keep long-shot companies from going public. Plus, some compa-

by focusing on just one or two projects involving potentially lucrative drugs for highly complex diseases. The hangover from all these excesses has left the market hostile to both IPOs and secondary offerings. As a result, Byers predicts, "maybe the top quarter" of companies will remain independent, while the rest will merge or go out of business.

Fidelity's Firestone believes the next 12 months will be critical for the industry. During this period, product approvals from the Food & Drug Administration and results from clinical trials are

brave pioneers made tentative investments. But health-care reform and pressure from managed-care companies have put the me-too strategy on the endangered species list. And traditional chemistry has run dry. So even though biotech may not be more efficient, mastering those tools has become essential to developing breakthrough drugs that will command premium prices.

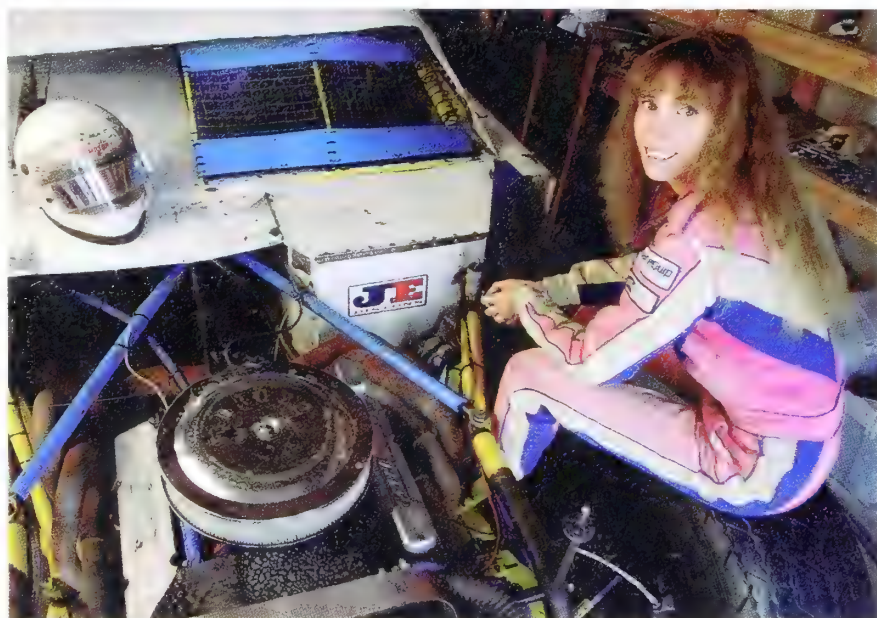
Don't look for big drug outfits to do many outright acquisitions unless the stocks get insanely low. Bristol-Myers and Eli Lilly tried that with Genentech Systems and Hybritech, respectively, in the 1980s, and it didn't pay off. For one thing, entrepreneurial scientists bristle at all the bureaucracy and bailed out.

There are other models, however: On the heels of the Genentech-Roche deal, a few biotech companies, including Genetics Institute, Immunex, and Systemix, sold a majority of their shares to big drug houses but retained publicly traded stock. Edward V. Fritzky at Immunex Corp., now 54% owned by American Cyanamid Co., says that "the model for biotech used to be entrepreneurial and independent. Today, it's entrepreneurial and highly collaborative."

Straight licensing deals can pay off for both partners, as Chiron and Biogen show. And large partners who have invested in Centocor, Protein Design Labs, CellPro, Cephalon, and Ligand Pharmaceutical, for instance, are offering resources, including cash and expertise to get access to promising products. Such deals will continue: "Biotech's on got about \$1.5 billion in partnering funds today, but big pharma is spending \$2 billion in R&D" each year with margin results, notes Burrill. "It's more efficient and increases flexibility for big pharma to contract out more research instead of carry a huge R&D infrastructure."

Those deals force a new reality on shareholders. The smaller outfits get research payments and royalties rather than blockbuster profits. Still, it's a far less risky and expensive way to build a business. "I hate the home-run model," says Synergen co-founder Larry Gold, now chairman of Boulder (Colo.)-based Nexagen. He has made sure his company spreads risk. Nexagen has technologies for generating large numbers of potential drugs that it's selling to different pharmaceutical companies.

One major hitch for biotech, however, is that for the moment, the big drug makers are engrossed in their own takeover deals and drug-distributor acquisitions. Besides, biotech bargaining power erodes daily. Why should big companies cut deals now if by waiting a few months they can get a lower price? Many large



"[I can] stay out of the hospital and do more"

KIMBERLY MYERS

Race-car driver and cystic fibrosis patient on Genentech's Pulmozyme

nies confide that certain investment banks won business by promising companies so-called research coverage—promotion—by the firm's biotech analysts. Ex-analyst Denise M. Gilbert isn't sorry she left the Street to join the biotech company Affymax Inc. after the bull market was over. She tired of trying to provide analyses on scores of stocks that tended to move "on a perception of an expectation." Also, "there was never an incentive to put a sell on a stock."

Management quality has been spotty, too: In the early days of biotech, many scientist-founders were accused of working on too many projects, sometimes going after human drugs, veterinary drugs, and agricultural projects simultaneously. More recently, a wave of pharmaceutical executives have entered the industry and adopted a "swing for the fences" mentality, notes industry consultant Mark Edwards at Recombinant Capital. They're increasing risks

expected on a dozen key products (table). Good news—and the enthusiasm it would generate—could rally the biotech sector and reward both the companies involved and others with access to more capital. If current trends continue, however, the news will be mixed or glum. That will hasten bankruptcies and mergers—which might themselves be rickety if the partners lack enough cash.

The wild card in how biotech consolidates is the large drugmakers. When biotech appeared in the late 1970s, big pharmaceutical companies were boosting profits mainly by churning out "me-too" drugs and raising prices. Many initially rejected biotech, while a few

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CADILLAC SMARTLEASE



drug houses are now negotiating from the posture, "You need a deal real bad? Here's a real bad deal," says Recombinant Capital's Edwards.

FIRE SALE. Many small outfits may end up licensing or selling their technology for peanuts. "They're having to take the crown jewels to the pawn shop," says PaineWebber Inc. analyst Linda I. Miller. Whether big drugmakers can push those technologies any faster than the small fry is anyone's guess, but

their size gives more leeway to try.

A few optimists still believe that all biotech needs is some fine-tuning—and a string of hits—for Wall Street to be resmitten. Most seem to be entrepreneurs running private companies, such as Louis G. Lange, CEO of CV Therapeutics, which is working on cholesterol-lowering drugs. He believes the market will come back on the strength of investors seeking jackpots. "If I was an investor, I'd say there's only about four worth in-

vesting in," he says. "But I'm talking about four that could go to the moon."

Like most entrepreneurs, Lange sure that his company will be one of the four. But as resources are stretched thinner in biotech, no one can count on salvation. Indeed, investors have finally realized what most gamblers eventually do: After a while, it doesn't pay to focus too much on any one hand when it's the long odds that are killing you.

By Joan O'C. Hamilton in San Francisco

GENE THERAPY: PROMISES, PROMISES

In the biotech universe, gene therapy ought to be a blazing star. Certainly the idea of tackling everything from rare inherited diseases such as cystic fibrosis to scourges such as cancer by slipping corrective genes into people is compelling. And breathtaking advances in technology have moved the field from fantasy to medical reality, spawning more than two dozen companies and bringing hundreds of patients into clinical trials.

So why are leading public gene-therapy companies such as Genetic Therapy, Somatix Therapy, and Viagene trading near their lows while startups postpone initial public offerings? Part of the answer, argue executives and analysts, is that investors are too ill-informed to spot the field's progress. After the failures of sepsis drugs and other biotech products, "we got unfairly tarred with the same brush," insists Tom D'Alonzo, CEO of GenVec Inc. in Rockville, Md.

Maybe. But gene therapy's financial doldrums also reflect the vast gulf between promise and product. While more than a dozen clinical trials are under way, most procedures are closer to basic research than viable treatments.

UNKNOWN PATH. Take cystic fibrosis. Researchers can insert correct copies of the flawed gene into patients' lung cells using modified pneumonia viruses and can show that cells use the gene to make a crucial protein. But huge hurdles remain before there's a cure. Lung cells may not make enough of the protein, and for only a few weeks. Worse, when scientists try to slip the gene in a second time, the body's immune system may reject it. Solving these problems will require new gene-delivery technologies. "It's kind of crazy," says James M. Wilson, head of the University of Pennsylvania's Institute for Human Gene Therapy. "We believe gene therapy will have a huge

impact on medicine within 10 years, but we don't know what technology will get us there."

Companies and academic scientists are working feverishly on innovative delivery systems—everything from modified herpes viruses and fat globules to synthetic compounds designed

A CROWDED LAB

Still years from selling products, two dozen companies are scrambling to commercialize gene therapy

DATA: BIOVENTURE VIEW

to carry genes through the blood to specific organs. But even if one of these hits the jackpot, there's no guarantee anyone will make money from it. The most obvious use of gene therapy is "fixing" flawed DNA in inherited diseases. But except for cystic fibrosis, which strikes one in 2,500 Caucasians, these diseases are so rare that the potential market for cures is tiny.

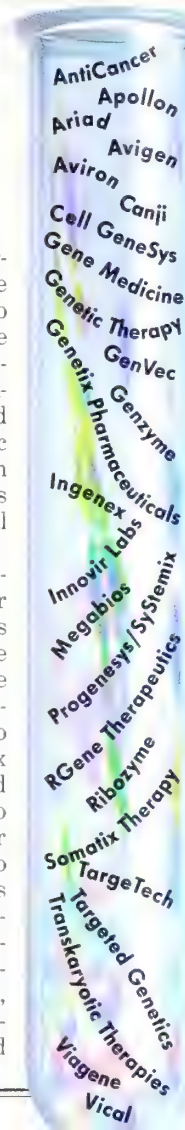
The search for more lucrative products has led a number of companies to target diseases such as cancer and AIDS, where payoffs are huge. But so are the uncertainties, such as finding the right pieces of DNA to use. In one approach, Somatix Therapy Corp., Vical Inc., and others are delivering genes to cancer cells to make the cancer more visible—and vulnerable—to the immune system. But years of failed efforts to boost immune defenses with conventional methods make many scientists skeptical. Another tack, used in trials sponsored by Genetic Therapy Inc. (GTI) and

partner Sandoz Pharma Ltd., is to slip genes into brain-tumor cells that make the tumor cells susceptible to a common drug. But critics worry about getting the gene into enough cells and don't think the approach will combat cancer elsewhere in the brain and body. "Cancer is going to be very tough," concludes Wilson.

TEAMING UP. It's no surprise then, that investors are bearish on gene therapy. "I refuse to invest in areas that I think are 10 years from market," says Sarah Gordon-Wilde, biotech analyst for the \$1.1-billion Amerindo Investments Ltd. fund. Executives say the timetable is far shorter—Vical CEO Alain B. Schrieber hopes to have his cancer product out by 1998. Even so, they know gene therapy won't be a Wall Street darling until cures appear. "We can't just tell scientific stories anymore," says Somatix CEO David W. Carter.

One stopgap measure is to find larger partners such as Sandoz, Genentech, and Rhône-Poulenc Rorer. In the end, though—as in much of biotech—a shakeout seems inevitable: "There's no need to have 10 gene-therapy companies," says Vical's Schrieber. It's an old story. Breakthroughs create a promising new field, but only a few hardy companies have a shot at the prize. "The logic for gene therapy is so compelling; there's a tendency to think it ought to be easy," says GTI's Marc R. Schneebaum, vice-president and CFO. It isn't.

By John Carey in Washington



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MS. SMITH GOES TO WASHINGTON

Women lawmakers are changing the shape of Congress' agenda



When congressional Democrats and Republicans took to the field in the summer of 1993 for their annual baseball game, it was obvious that this was not some old grudge match between teams of over-the-hill frat boys. For the first time, the boys let three girls play, too. "I'm not sure at the very start that they were interested in having women play," says Representative Maria Cantwell (D-Wash.), the first woman to reach base in the Capitol classic's history. "But eventually, they accepted me."

The baseball breakthrough parallels a more significant change: Women lawmakers are playing political hardball on Capitol Hill. Thanks to a milestone election in 1992—female membership soared from 2 to 7 in the Senate and from 28 to 47 in the House—male veterans are reluctantly accepting what might well be deemed a sexual revolution in the legislative agenda.

Not only has the Congressional Caucus for Women's Issues seen its family-oriented agenda take center stage but also women lawmakers have made a difference on a broad range of other issues. They have sparked institutional reforms and have cast decisive votes on the top issues of the 103rd Congress—deficit reduction and gun control.

"They've brought a lot of idealism and a lot of energy to issues," says House Majority Leader Richard A. Gephardt (D-Mo.). "They've had a big impact."

Consider the bill to restrict product-liability suits, which the Senate killed in June. Arguing that it would curb women's rights to sue makers of defective health devices, the Senate's freshman Democratic women cast the key votes to sustain a filibuster that doomed the measure. "If there hadn't been as many women in the Senate, the issue would have been dead and buried," crows consumer activist Pamela Gilbert, director of Congress Watch.

Congressional women don't think alike on everything, of course. Unlike the Congressional Black Caucus, whose 38 Democratic members usually vote in liberal lockstep, the 40 Democratic and 14 Republican women gen-

erally join forces only on social issue where they are largely progressive. "We have some vast differences philosophically, but it is amazing how we come together on issues of importance to women," says Representative Olympia Snowe (R-Me.), a caucus co-chair.

"WONDERFUL." As a result, 55 bills backed by the bipartisan Women's Issues Caucus are expected to become law in this Congress, compared with 39 in the last Congress and 19 in the previous one. Among them: national criminal-history checks for child-care provider; tougher child-support enforcement law; an end to the rule banning women from combat ships, and a requirement that the Resolution Trust Corp. reserve contracts for women-owned businesses. Senator Patty Murray (D-Wash.), who once quit work to care for her children, pushed hard for the Family and Medical

SNOWE: "IT IS AMAZING HOW WE COME TOGETHER ON ISSUES OF IMPORTANCE TO WOMEN"

Leave Act. And Representative Carrie Meek (D-Fla.), a former domestic worker, won new labor protections for women who clean houses. "We'd been at it for five or six years on some of these things," says Representative Patricia Schroeder (D-Colo.)

caucus co-chair and an 11-term House veteran. "It's wonderful to see things getting to the 'out' box."

During debate over 1994 appropriations, the 17-year-old caucus persuaded Congress to reorder spending priorities—boosting funding for women's health research, including breast and ovarian cancer and osteoporosis. The caucus has notched nearly a dozen abortion victories, including the expansion of abortion availability for military women, federal employees, and rape and incest victims.

An even bigger pro-choice victory came in May, when President Clinton signed a bill outlawing blockades of abortion clinics.

Even if Clinton hadn't favored that law, he would have owed female lawmakers one: His 1993 economic plan would have died without the near-unan-

WOMAN POWER: STILL GROWING, BUT SLOWLY

HOUSE

Last Congress	28
Current Congress	47
Women seeking reelection this year	44
Total women running for House	106
Next Congress (Projected)	50

SENATE

Last Congress	2
Current Congress	7
Women seeking reelection this year	2
Total women running for Senate	8
Next Congress (Projected)	9

DATA: BUSINESS WEEK, NATIONAL WOMEN'S POLITICAL CAUCUS

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mous support of Democratic women. In the House, 33 of 35 Democratic women stood by their man—even though Clinton's tax hike was unpopular back home—while 16% of Democratic men voted no (as did all the GOP women).

Women played an equally pivotal role in passing the assault-weapons curbs that Clinton signed into law on Sept. 13. In the House, women not only provided the two-vote margin of victory—83% of women vs. 46% of men supported the ban—but also worked behind the scenes lobbying colleagues. In the Senate, chief sponsor Dianne Feinstein (D-Calif.) emerged triumphant despite a withering barrage from the gun lobby.

Considering that most of the women are strangers to Capitol Hill, they're adept operators—and organizers. The women's caucus holds regular bipartisan strategy sessions, and—more unusual—members work out together in the House gym. What's more, newcomers meet regularly for women-only dinners, comparing experiences and getting pointers from veteran colleagues.

Displaying a bit of female chauvinism, first-term Representative Jennifer B. Dunn (R-Wash.) contends that organization comes naturally because "a lot of us have raised children. Sometimes, the men seem surprised that we are such good follow-through people." Patience and persistence, other traits accomplished parents develop, also have paid off for frosh: California Democratic Representative Jane Harman pushed tenaciously in

committee to save the C-17 transport plane built in her district. And Cantwell, a high-tech expert, doggedly lobbied Vice-President Al Gore until he modified a controversial "clipper chip" encryption proposal strongly opposed by Microsoft Corp., based in her district.

SILENT TREATMENT. The women's style doesn't always score runs with the men's club. When Representative Karen Shepherd (D-Utah) proposed banning lobbyists' gifts, she got the silent treatment. "I went through a week when nobody was talking to me on the floor," she recalls. "But I gutted it out, and the bill passed." Shepherd later won approval of a law ending lifetime staff subsidies for former Presidents and House Speakers. Representative Karan English (D-Ariz.), meanwhile, compelled the House to ban use of congressionally accrued frequent-flyer miles for personal trips. The Old Bulls are still smarting. Complains one top aide: "They're very, very demanding."



**CANTWELL:
EMPLOYING
HIGH-TECH
SAVVY TO FORCE
CHANGES IN THE
"CLIPPER CHIP"
PROPOSAL**

The caucus may get even more so after the November elections—though women's gains won't be like 1994's (table, page 96). In the Senate, Feinstein fighting for survival against Representative Michael Huffington (R-Calif.), who spending much of his family fortune paint her as a Clintonesque waffler. In the House, men are likely to replace three departing women.

Of the House incumbents running again, many Democratic women face

**FEINSTEIN: AS
PRIME SPONSOR
OF ASSAULT-
WEAPONS
CURBS, SHE
BESTED THE
GUN LOBBY**

tough races. The most endangered are first-termers who were elected as outsiders in swing districts last time but now are seen as novice insiders in a decidedly anti-incumbent year. "They came to Washington

and superglued themselves to the Democratic leadership," says Karen Kerrigan of the Small Business Survival Committee, a conservative group. "They made themselves part of the problem and playing the woman card back home isn't going to cut it this time." Further, the number of open seats—easier for women to capture than incumbent seats—has shrunk to 50 from 91 in 1992. The shift in issues won't help. Crime, Topic A, and polls show that voters often see women as soft on criminals.

The National Women's Political Caucus fears a loss of five to eight female incumbents this fall. "We're all marginal," worries Shepherd. Still, incumbent losses are likely to be more than offset by newcomers' victories.

Even so, Hill women will hold little more than 10% of congressional seats. "We still have a long way to go," says Snowe, who's running for the seat of retiring Senate Majority Leader George J. Mitchell. For one thing, the seniority system deprives them of committee chairmanships. That should change next year, when retirements are expected to make Schroeder chair of the House Post Office & Civil Service Committee.

A few women are expected to assume top party leadership spots next year too. Senator Barbara A. Mikulski (D-Md.) is favored to win her party's No. 1 Senate job, while Representatives Barbara B. Kennelly (D-Conn.), Louise M. Slaughter (D-N.Y.), and Susan Molina (R-N.Y.) are vying for House posts.

Congressional women are too numerous and skillful to be ignored again. But they must expand their roster and acquire seniority to become team captains—not just versatile utility players.

By Richard S. Dunham in Washington



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SCOTT COOK WANTS TO CONTROL YOUR CHECKBOOK

His company, Intuit, is king of personal-finance software

Scott D. Cook is too polite to change the subject, but if you ask him about his competition, don't expect a straight answer either. First he will tell you what you already know—that Intuit Inc., the \$228 million personal-finance-software company he started from scratch in 1983, faces a host of rivals. Then, he'll launch into his favorite evasive tactic. "There is one competitor we have in all our businesses," he'll say. "We've faced them for years, and they're really rough."

With that, Cook will produce a mechanical pencil from his pants pocket, which you expect he'll use to spell out Microsoft Corp. on the piece of paper in front of him. Instead, he holds it up like some sort of talisman. "This is our main competitor," he says, grinning. "This guy is low-cost, easy to use, and it won't crash and eat your data. Virtually every one of our customers switches from this when we get 'em."

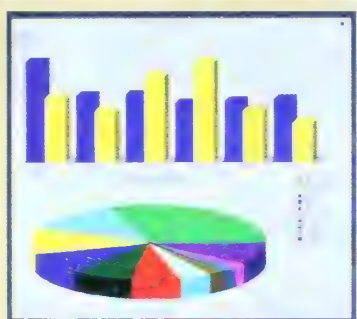
MELEE. Cook, of course, is aware that Microsoft is gunning hard for Quicken. Intuit's vastly successful personal-finance program. He also knows that he has outsold the world's largest software company at least 6 to 1 in the personal-finance market by focusing intently on the habits of potential customers, not those of rival software companies. If he was unnerved when *Newsweek* magazine recently portrayed Microsoft's powerful chairman, William H. Gates III, as settling over Quicken's big lead, Cook is not showing on. His wife, Signe Ostby, however, is more demonstrative: "When I saw that, I just wanted to throw up," she says.

Who could blame her? Scott and Sig-

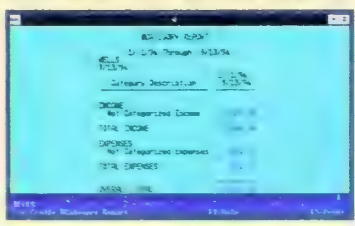
ne know well the vagaries of the computer industry. Although Intuit came close to pulling them into bankruptcy court (and unraveling their marriage) when it ran out of cash in 1985, it has blossomed into a hot-growth company with a market value of \$804 million, 23.4% of which is owned by Cook. Until recently, Intuit had expanded quietly as word spread that Quicken offered even the worst computerphobe an easy way to pay bills, track a checking account, and budget finances. Then, its near 70% market share drifted onto Gates's radar scope and caught the Boy Wonder's attention.

Now, the 42-year-old Cook finds himself in the middle of a high-tech melee to automate the way people manage their home finances. Not only has Gates doubled the size of the team that's pushing Quicken rival Microsoft Money, but he is also "personally committed to giving us whatever resources we need" to catch Intuit, says product unit manager Leslie Koch. The Microsoft Money team, she explains, has one goal: to grab the lead in on-line financial services, the market's next logical extension.

Giving customers the ability to pay bills, receive statements, and enjoy other financial services electronically is quickly becoming banking's holy grail. It may be a small market now. But the rush is on to establish links into the home. In the past few months, MasterCard International Inc. and Visa International—both of which are bank associations—have set up units dedicated to developing and marketing the tools necessary for banks to offer such services widely. Both plan to offer a variety of



QUICKEN TODAY AND IN 1987: THE PROGRAM DRAWS RAVES FOR GUIDING USERS THROUGH ITS MANY FEATURES ONE EASY STEP AT A TIME



SCOTT COOK AND SIGNE OSTBY: HER FRUSTRATION WITH PAYING BILLS LED TO QUICKEN

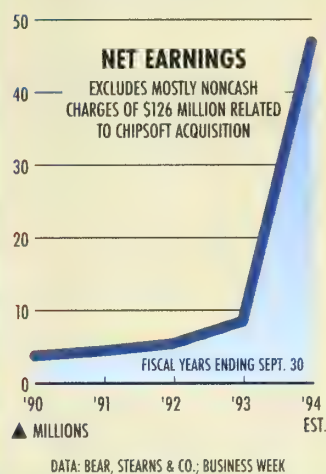
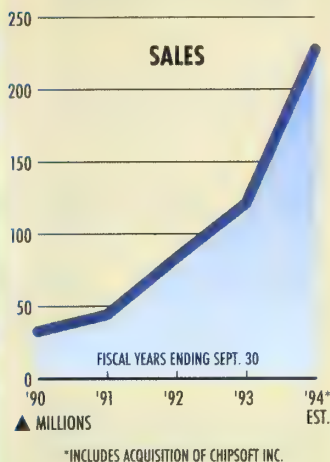
so-called customer interfaces: PC software, simple Touch-Tone phones, and computerized phones with small screens so users can view information (chart).

Koch won't comment, but sources say Microsoft is negotiating to align its Money program with MasterCard's MasterCard Banking unit in order to gain access to MasterCard's affiliated banks. And Visa Interactive division has linked up with another Quicken rival—H&R Block Inc.'s Managing Your Money.

While Intuit is going on-line, too, it's apparently doing so without the benefit of a broad-based strategic alliance with one of the bank-card giants. It already has a relationship with Visa to mark the Quicken Visa card, which lets users download statement information onto their PCs automatically. A user can also pay bills electronically through Quicken by tapping into a transaction processing named Checkfree Corp. But earlier this year, sources say, talks broke down between Intuit, Visa, and several banks to create much broader electronic links. And since Checkfree will be part



INTUIT'S ROCKET RIDE



push of a button. Cook calls it "mainframe Perestroika": the liberation of account information from the gulag of banking's clunky mainframe-computer system. He has dedicated Intuit to seeing that it happens.

Cook is also out to find as many ways to manipulate the data as possible. Last year, Intuit doubled its size with the \$306 million purchase of San Diego's ChipSoft Inc., the publisher of the popular TurboTax programs for preparing income-tax returns. It also has announced its intention to buy Parsons Technology Inc., which has programs that help with buying a car or getting a mortgage.

NOT CRISCO. Although the acquisitions will plunder reported earnings over the next few quarters because of several noncash charges, they are key to Cook's strategy. He wants to bundle all the information together to create a reservoir of personal-finance knowledge that's as deep as you want to go. Some products might be delivered via CD-ROM, some over a modem. One thing is certain, however: The more Intuit has to sell, the better. The company draws 30% of its revenue from selling Quicken checks and forms that fit in your printer. In

terCard and Microsoft's alliance, that relationship could be short-lived.

In July, Cook spent \$7.6 million to buy National Payment Clearinghouse Inc. (NPC), a Checkfree competitor that had been processing electronic transactions with Microsoft Money (which is why Microsoft plans to embrace MasterCard). NPC will use it to connect Quicken directly to banks for a variety of interactive services. Whether he can do so quickly without help from one of the bank-card companies is an open question.

Cook's view is that a credit-card company is an unnecessary middleman. Banks will want to work with Intuit because Quicken is far and away the favorite choice in the market. "Banks can see that consumers have voted with their dollars," he says. It might be easy to look at Microsoft's \$4.7 billion in sales and cash flow and conclude that ultimately Cook doesn't have a chance. But Intuit's history would suggest that Cook has designed a better mousetrap. The mousetrap is the organization Cook has built, not the Quicken pro-

gram itself. Intuit's QuickBooks program is just as dominant in its market—small-business accounting software. And a version of Quicken rewritten almost entirely for the German market has blown away the competition in that country, including Microsoft Money. What Cook has done is figure out how to run a company that can identify market needs and consistently develop easy-to-use computer software to meet them.

While most software programs are about as simple to use as a spaceship, Quicken draws raves for guiding users through its many features one easy step at a time. Right off the bat, the program lets you organize your accounts almost effortlessly. As you gain experience, you can speed up the process and tap into more complicated tasks.

The one problem with Quicken and similar programs is that entering data is a hassle. Once you get used to the power of automation, it begins to feel natural that you should be able to pay your bills electronically and download information from your bank accounts at the

the on-line future, Intuit wants a slice of each electronic transaction.

The company's ability to deliver what customers want is often attributed to Cook's early-career experience at Procter & Gamble Co. (That's where he met and fell in love with Signe, who was also a marketer there.) This seems unfair. Although he learned the ins and outs of consumer marketing at P&G, developing something as complicated as software bears little resemblance to the selling of Crisco, the account he spent the most time on.

In fact, associates say, Cook's brilliance lies in his uncanny ability to seize on a problem, hear from all sides, and synthesize a coherent solution. He has taught his company to do the same. Cook's ego is absent from most decisions; the weight of the evidence carries the day. Personal Finance Group General Manager Eric Dunn, one of the chairman's early hires, says he most admires Cook for his intellectual honesty. "He is a very fair person and very analytical," Dunn says. "And the rea-

son he's fair is because he is analytical."

Cook's passion for analysis borders on the compulsive. L. John Doerr, the veteran venture capitalist from Kleiner Perkins Caufield & Byers who sits on Intuit's board, still marvels at the process Cook put him through before Doerr was invited to join the company. Cook was seeking a select few venture partners to buy out some shares owned by the founders and provide advice on how to manage the company's growth.

The process took nine months and several rounds of interviews, and, finally, each finalist was required to write a detailed case study to demonstrate his ability to think strategically. The topic:

could discuss it around the campfire. Signey says her husband is just as focused at home. Landscaping the yard can be a science project: "He'll want to move two bushes three feet because he has analyzed all the views and they look better from the particular chair on the porch he wants to sit in," she says.

Friends say Cook has been that way his whole life. Growing up in the middle-class Los Angeles suburb of La Cañada, Scott was a nerd in school, but a popular one. He was salutatorian of his high school class and student body president. He also was voted most likely to succeed. John Selling, an old friend who is now a gastroenterologist in Menlo Park,

So Cook decided to design one. His first step was to hire a Stanford University programmer named Tom Proulx (who this year took a leave of absence from the company). Together, they developed a piece of code that could easily write checks and store personal financial data. From the start, Cook placed emphasis on dogged customer research. He enlisted the Junior League to test the product and sat next to each subject with a clipboard, watching as she attempted to write a check.

INTENSITY. The emphasis today is no different. Intuit is maniacal when it comes to customer research and feedback. The "usability lab" runs full-bore throughout the design of each product. An ombudsman funnels suggestions from telephone help lines into a central database, where they are categorized and analyzed. Engineers are sent out to customers' homes to watch them grapple with the software. "The value is in watching the customer flail," says Jacqueline Maartens, group project manager for Quicken.

Since launching its home-product line, Microsoft is doing many of the same things. The difference is a matter of degree. Intuit is so focused on personal finance that its engineers have become experts on the customer's needs and behavior. "You start to build that into your fabric," says Maartens. "Once the engineers are sensitized, they've already figured out what the customer is going to have trouble with. It's kind of a self-sustaining thing."

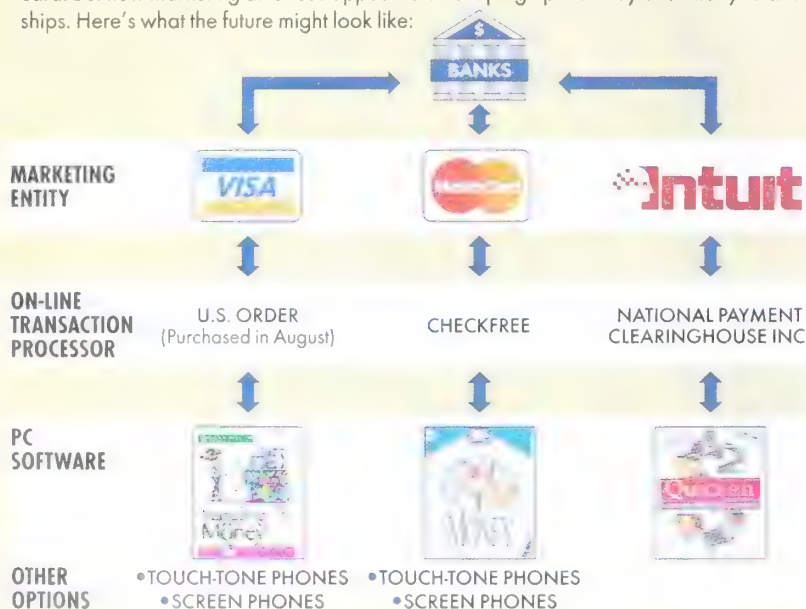
Unfortunately, Cook's intensity of focus can sometimes be a little off-putting. During a speech at a big home-banking conference in May, several participants say, Cook's open disdain for screen phones and other less ambitious home-banking applications turned off some of the conservative bankers in the crowd. "We want to offer all the applications," explains Susan Terry, a vice-president at First Tennessee Bank in Memphis. "Some people don't want to do all the things these programs can do. They just want to pay bills."

That's where programs with a choice like Visa's and MasterCard's could provide an edge. Cook will have to wrestle with that as his team sets out to sign up banks on its own. He can take comfort, however, in the opinion of Joseph S. Pendleton III, senior vice-president of Meridian Bancorp. in Redding, Pa.: "We want to open up as many doors and corridors as possible," Pendleton says. "Market share will ultimately guide my decision [which to keep]." For the time being, anyway, that's a game Intuit wins hands down.

By Michael O'neal in Menlo Park, Calif.

THE EMERGING LANDSCAPE IN ON-LINE BANKING

Quicken users can now pay bills through Checkfree Corp. and apply for a Quicken Visa card. But new marketing alliances appear to be shaping up that may alter many relationships. Here's what the future might look like:



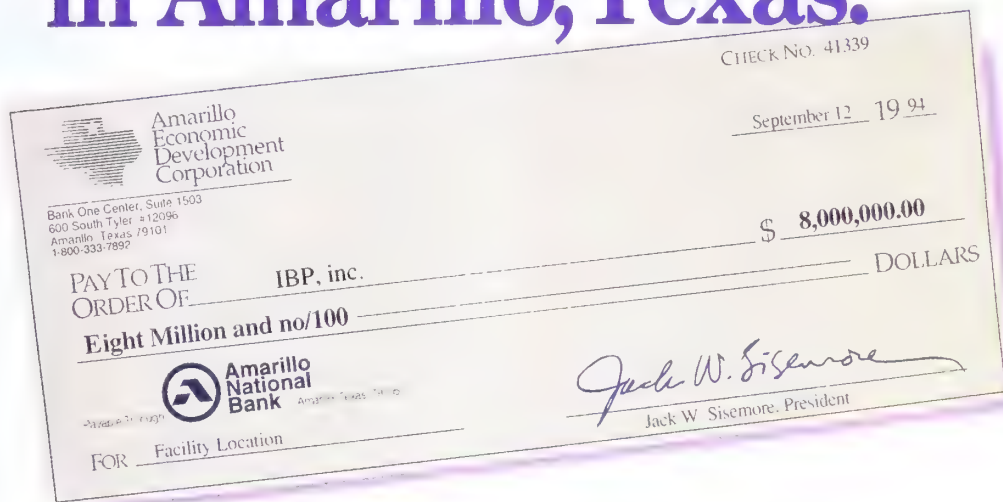
how to respond if Microsoft entered the market. "I couldn't believe how long it took," Doerr says. "But I just liked Scott. He has more passion for stakeholders than any founder I've worked with." (Doerr ultimately introduced Cook to Intuit's new CEO—Apple Computer Inc. veteran William V. Campbell—who, after countless interviews of his own, was tapped to help streamline operations and speed up decision-making.)

Cook, who is all the time quoting from technological history, has a touch of Ben Franklin about him. He is unfailingly friendly and outgoing, but he's not one to make chitchat. Before his yearly backpacking trip with high school buddies last summer, he asked each of them to read an article on East-West relations in *The Atlantic Monthly* so they

Calif., says Cook spent his spare time racing an old Fiat at a local track. He also liked to play cards and spent many hours at the school's computer analyzing whether a card-counting strategy could beat the odds in baccarat. Signey says if his father hadn't pushed him into business he would have been an engineer.

Cook's résumé is top-notch: a double major in mathematics and economics from the University of Southern California, an MBA from Harvard University in 1976, four years in Cincinnati with P&G, and an additional three years as a Bain & Co. consultant in Menlo Park. It wasn't until 1983 that he got the itch to go it alone. His epiphany came as he watched Signey pay the bills. The tedious work begged for automation, yet there wasn't a good computer program available.

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Commentary/by Emily Smith

CAIRO: A VICTORY FOR WOMEN—AND THE WORLD

With a moxie and finesse that Washington politicians might envy, the Vatican preempted the recent International Conference on Population & Development in Cairo, transforming abortion, a relatively minor item on the agenda, into the centerpiece of negotiations. For five days the Vatican and its allies held up other action while delegates, including Vice-President Al Gore, danced to charges that the conference plan represented a "right to abortion on demand" and Western "imperialism."

By the time delegates from more than 150 nations—minus the Vatican—endorsed on Sept. 13 a landmark plan to curb world population growth, the significance of the meeting and its blueprint for action were obscured. In the end, the Cairo meeting fused population policies with development goals to produce the most sensible population plan yet: One that depends on social and economic gains for women to rein in birth rates.

The Cairo conference is part of a series of U.N. meetings that began with the Earth Summit in 1992 and will wrap up next year with The World Summit for Social Development and then the Fourth World Conference on Women. Policy makers hope the meetings will lead to a new consensus on ways to promote development, curb population growth, protect the environment, alleviate poverty, and enhance the rights and opportunities of women and children.

THE SOFT SIDE. Increasingly, policy makers think that dealing with these "softer" issues is a key to maintaining political stability around the world. It's also important for improving social and economic welfare, especially in poor countries and those that are spurring growth through trade and market liberalization. The consequences of China's hyper economic growth—including the rapid degradation of soils, forests, and

water and a huge migration to the cities—are stark reminders of the negative fallout of failing to address these concerns.

Despite their many flaws, the U.N. meetings are the only significant venue for tackling these issues. And they do have an impact. "Global forums validate norms, targets, and issues that will bear fruit over several decades," explains John W. Sewell, president of the Overseas Development Council, a

proaches—in addition to ones that promote women's political rights, reduce infant mortality, and provide access to broader reproductive health services—lead women to want fewer children and make them partners in economic development.

The Cairo plan, which eventually will cost \$17 billion a year—about \$5.5 billion from donor nations—is already giving aid programs a facelift. Several nations pledged increases for population aid: Japan \$3 billion and Germany \$2 billion over the next seven years. The U.S. Congress has approved \$580 million for population aid in fiscal 1995, double the 1993 figure. Countries with successful programs that combine family planning, education, and opportunities for women intend to share their expertise with nations that want help. And both the World Bank and U.S. Agency for International Development plan to launch integrated health, education, and loan programs for women.

FILLING IN GAPS. The meetings on women and the social summit will pick up where Cairo left off. The women's conference in Beijing next September is charged with drawing up policies to ensure women's equal participation in society. It will likely incorporate Cairo's goals for eliminating the education gap between girls and boys. The social summit will set measures to alleviate abject poverty, which keeps about 1 billion people undernourished and without adequate housing or health care. U.N. officials then aim to integrate all four sets of recommended actions into a single action plan. Ambitious—yes, idealistic—probably. But if these activities do nothing else, they will foster public debate over pivotal issues that all too often are ignored.

Those are the sorts of benefits that didn't make the headlines about Cairo



Success story: In Bangladesh, educating girls and preparing them for work are helping to slow population growth

research organization on development. The process catalyzes social and economic research on the issues, which then contributes to more sophisticated policy.

This certainly happened in Cairo. Despite the hoopla over abortion, the plan ratified there represents an unprecedented shift in population policy—and huge gains for women. Most important, based on recent experience in nations such as Bangladesh and Indonesia and reams of new research, delegates recognized that slowing population growth hinges on programs that educate and enhance the economic prospects of women. These ap-

Smith covers population issues for BUSINESS WEEK.

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Color Me Beautiful works with hundreds of colors. IBM helped them enhance one: Green.

Five years ago, at our first meeting with Steve DiAntonio, President of Color Me Beautiful, he told us quite frankly:

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And no, IBM was *not* the most expensive. In the words of Lee Nelson, CFO, "We shopped around. Not only were they very competitive, but the guys from IBM talked about tailoring a system

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A CHASTENED CHASE

The humbled bank starts to revive—by transforming its culture

The room was becoming all too familiar to the 25 weary executives. For two days, sitting in a circle at a conference center an hour north of Manhattan, they had gathered to talk about the direction of their company. There were moments of levity. The executives poked fun at the saddle shoes worn by the pony-tailed consultant leading their sessions and came up with nicknames such as "Boy George and the Culture Club." But for the most part, the discussion seemed an endless recital of complaints. "It was a very gloomy group," says one participant.

Then, the consultant gave the executives new assignments: First, rate and discuss their working relationships with each other, and later, break into groups of five to assess their own management skills, tell the group about those assessments, and take feedback. After some hesitation, the 25 men began talking openly, speaking their minds to each other in ways many had never done before. Says one attendee: "Most of us thought we were terrific, but most of our panel members had slightly different views."

TOUCHY-FEELY. Once they began saying difficult things to each other, they began to develop a new degree of trust. They started to drop some of the feuds and rivalries that had divided them for years. One executive says he told his wife afterward: "Those were the four days that changed the Chase."

Chase? Chase Manhattan Corp. was once, with good reason, among the proudest banks in the world, hardly the kind to subject itself to such an est-like touchy-feely encounter session. Chase bankers had entree to corporate and government leaders around the world. Its client list was the envy of bankers everywhere. Chase was the Rockefellers' bank.

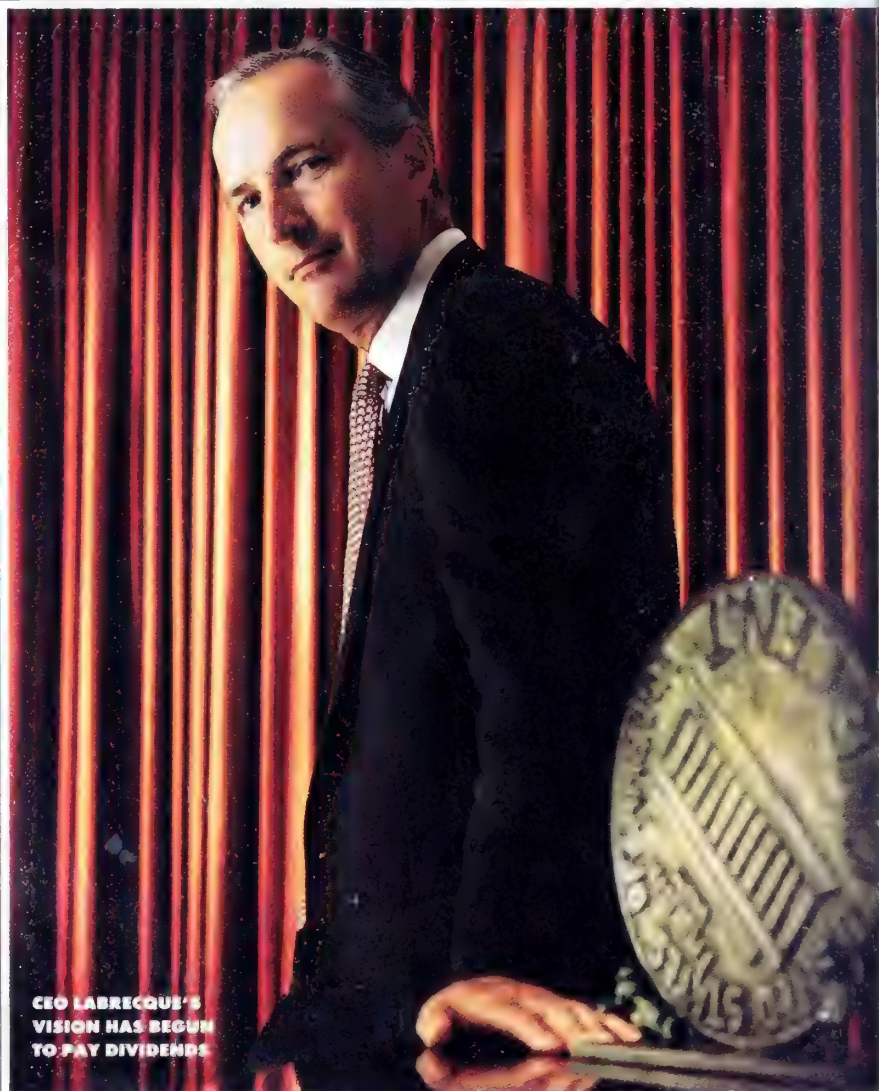
Chase had been humbled, though. A decade of missteps and blunders common to many big banks—from loans to less developed countries to a major push in commercial real estate—had bled bil-

lions of dollars in capital from its books. In 1989, Chase lost \$665 million. In 1990, it halved its dividend and reported a \$334 million loss. And every time Chase seemed to be surmounting a difficulty, a new one would surface.

Chase had even bigger internal problems. Top executives, each eager to build a big personal empire, had pushed Chase into a panoply of businesses, creating

an unwieldy institution with a finger in nearly every finance pie but with dominance in none. Turf battles and a near-total lack of cooperation made it almost impossible, Chase veterans say, for the bank to contend with tougher market conditions. "We just didn't seem to get things done," says Fred B. Koons, executive vice-president and head of Chase Manhattan Mortgage. "We always seemed to be at cross-purposes." The bank's weakness had become so pronounced that by the early 1990s, betting was widespread on whether Chase would have to merge or be acquired by another bank.

Thomas G. Labrecque, installed CEO in October, 1990, had taken some of the necessary steps to turn Chase around by the time of the July, 1991 retreat at the Doral Arrowwood conference center in Rye Brook, N.Y. He had begun to get finances in order and so peripheral businesses. But at Arrow-



CEO LABRECQUE'S VISION HAS BEGUN TO PAY DIVIDENDS

Labrecque launched his boldest undertaking, which continues today: reforming the culture of an enormous, 200-year-old institution and injecting enough teamwork and flexibility to turn it to its old prominence.

Early signs, while far from conclusive, offer grounds for hope. To be sure, vestiges of the old cautious, territorial culture remain. And Chase has a long history of failed reform campaigns. But squabbles have become less widespread, and executives from different parts of the bank are beginning to collocate. These changes are starting to show on the bottom line. Return on equity for the first six months of 1994 is a hefty 18.1%, which tops almost all of Chase's major rivals.

VULNERABLE. Chase's low stock price remains a major handicap. Despite the healthy profits and improving credit rating, Chase's shares, at \$36, trade below its book value. That makes it difficult for Chase to make acquisitions for as long and more important, it makes itself vulnerable. Labrecque, 56, is

determined to reduce that vulnerability.

Ironically, Labrecque, a product of the old Chase culture, is an unlikely change maker. He joined the bank in 1964, fresh from four years in the U.S. Navy, and never left. Then-CEO Willard C. Butcher named him president in 1981, and the 42-year-old executive earned the nickname "Tom Terrific" from detractors, who said he replied "Terrific!" to Butcher's every plan.

Labrecque, though, says he saw internal politics looming as a potential problem more than 20 years ago. As chief of staff at then-Chairman David Rockefeller's executive office in 1970 and 1971, Labrecque says: "I watched what happened when the place operated with silos [autonomous business units]. I was there in the meetings. I was preparing the memos." The bank he saw lacked focus and suffered from lax customer service and constant turf wars. "We had a great name, a great franchise, and we had messed it up," he says.

Labrecque believed Chase could easily improve individual products such as credit cards over time.

But "if you take all our product companies, as good as they are, there's someone out there who's as good," he says. And with executives often unwilling to help another Chase unit work with its clients, even strong products wouldn't get the exposure they needed. Labrecque wanted Chase bankers to change the way they operated: to team up and develop joint strategies so that the bank could expand its relationships with clients. At the annual senior management meeting in early 1992, he called for a new mission statement for Chase to establish long-term objectives along these lines.

Nothing happened. Those in charge of drafting the statement could not come to any agreement. The impasse continued until the spring, when Labrecque and President Arthur F. Ryan heard about a program called VisionQuest from W. Mathew Juechter, CEO of consultants ARC International.

VisionQuest's goal, says Juechter, is to get languishing companies to reinvigorate themselves. The process begins by forcing top executives to confront each other candidly. This allows them to work through issues that in the past have been intractable. The resemblance to the controversial est program of the 1970s is far from coincidental: VisionQuest grew out of the so-called human potential movement, which also spawned est.

Juechter says no one working for ARC International has been affiliated with est, and Labrecque says the bank modified VisionQuest to suit its own needs.

As part of the executives' meeting, VisionQuest calls for them to produce a statement of values and corporate vision. At Arrowwood, that provoked heated arguments. Could Chase say publicly that it wanted to be the best financial-service organization in the world when it was clearly something less? Was it appropriate to set an AA credit rating as a goal when the bank was rated several notches below that?

SIGNING PLEDGES. Eventually, the executives decided that Chase's mission was to become the best financial-services provider in the world. And they defined five values: customer focus, respect for each other, teamwork, quality, and professionalism. At the final evening's dinner, they signed a pledge to behave more constructively toward each other.

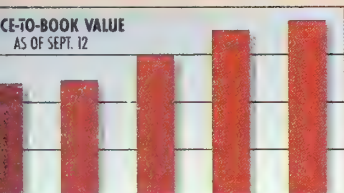
After Arrowwood and several similar meetings for senior executives, Labrecque decided that all 34,000 Chase employees should learn about the new vision. That process is continuing today. Every employee is attending at least one full-day session devoted to instilling the new values. The values are visible everywhere at the bank: An enormous banner inscribed with the vision statement and values hangs in the entrance hall at Chase's lower-Manhattan headquarters. And coffee mugs inscribed with the values adorn hundreds of desks.

Even employees' performance evaluations are changing to include measures of their adherence to the new values. Soon, credit-card-division workers' pay may swing up or down by as much as 25% based on how they measure. Executives have already felt the effects of VisionQuest in their paychecks: Robert D. Hunter, executive vice-president in charge of national consumer products, says less than half his compensation is tied to the performance of his own businesses, and "it's amazing how that changes your attitude."

Labrecque himself, the former "Tom Terrific," is extraordinarily keen about the program. His stiff, formal demeanor—seated, he looks as if his back never touches the chair—belies his enthusiasm. An easel in his office holds three drawings made by employees who were asked to illustrate what the new values meant to them. He helps conduct some of the one-day sessions himself. Says

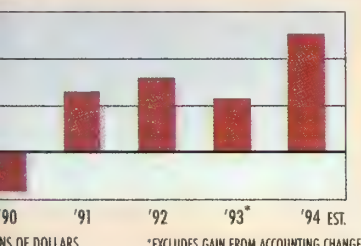
DOING BETTER THAN THE MARKET THINKS

CHASE STOCK LAGS...



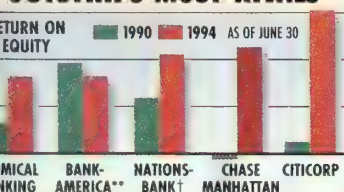
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NET INCOME IS RISING...



*EXCLUDES GAIN FROM ACCOUNTING CHANGE
DATA: CHASE MANHATTAN CORP.; ZACKS INVESTMENT RESEARCH

...AND RETURN NOW OUTSTRIPS MOST RIVALS



**1990 FIGURE DOES NOT INCLUDE DATA FROM MAJOR ACQUISITION
†PRO FORMA, AS IF MAJOR ACQUISITION TOOK PLACE IN 1990
DATA: BRIDGE INFORMATION SYSTEMS INC.; KEEFE, BRUYETTE & WOODS INC.

Finance

Robert R. Douglass, a former vice-chairman of the bank: "He sees his role in the company as leading this change. He has become a real missionary."

Labrecque's zeal for promoting teamwork may be rooted in his upbringing. The third of eight children of a New Jersey judge, Labrecque grew up in a close-knit family. (His entire family still lives in New Jersey.) He also played several team sports in high school and at Villanova University, where he earned his BA. As a young executive at Chase, Labrecque won plaudits during New York City's fiscal crisis in 1975 for his ability to mediate between the city's unions and its lenders.

Today, Labrecque has established a strong team of two to run Chase. Ryan is a cigarette-smoking technology maven who rose through the ranks, including a stint running the consumer bank, with the help of Labrecque's sponsorship. He is a contrast to the trim, fit CEO, who won his stripes on the corporate side of the bank. But Ryan's management strengths—encyclopedic knowledge of the operations of the bank and an incredible memory for detail—complement Labrecque's more laid-back style. "I'm probably more actively involved in business strategy and execution," says Ryan. "He's probably more involved with regulators and other constituencies."

"RIGHT DIRECTION." Labrecque has a ways to go before Chase can be called a transformed company. The bank has been performing well, says Paul W. MacAvoy, a Chase director and the former dean of Yale University's School of Management. He adds: "All I can say at this point is the great ship of state has left the harbor and is heading in the right direction." Teamwork and flexibility are nice values for a company to espouse. Banners, coffee cups, and employee surveys are pleasant boosters of morale. But Chase needs more than improved morale.

Officials at other companies who have used VisionQuest say it is only a starting point for the business of improving bottom-line performance. The program laid the foundation for major changes at Duke Power Co., in Charlotte, N.C., says Christopher C. Rolfe, vice-president for organization effectiveness there,



PRESIDENT RYAN'S STRENGTHS: OPERATIONS, TECHNOLOGY—AND DETAILS

but it "needs to be looked at as a piece of the puzzle, not the puzzle." And Chase is hardly the first bank to latch on to teamwork. J.P. Morgan & Co. is well known for doing business with clients on a number of fronts, and even Citibank, long a competitive company, is trying to foster more cooperation between business units.

For Chase, the new cultural campaign is risky. If it does not add to the bottom line, Labrecque will face renewed cynicism and infighting among his troops. Instead of winning praise as a visionary, Labrecque could find himself tagged a Neronian fool—fiddling with ephemeral values when Chase's core business badly needs fixing.

The new stress on teamwork is beginning to have an effect, though. A proprietary computer program Chase uses to track client relationships shows that 27% of Chase's top clients have begun using more of the bank's services since the summer of 1992. Revenue from those clients increased 78% in 1993 and is rising again this year. Global risk-management chief Mark B. Grier says that his group's foreign exchange revenues from corporate-finance clients have tripled since mid-1992, and his business with clients of Chase's cash-management and funds-transfer businesses is up 65%. More than half Grier's business this year has come

from internal referrals.

Canandaigua Wine Co. is typical of the companies increasing the work they do with Chase. The upstate New York winery has long been a Chase client for banking services. But now, says President Richard Sands, in addition to borrowing money, Canandaigua is using Chase's merger and-acquisitions advisory services and its capital-markets expertise for deals such as its \$437 million acquisition of the Almaden and Glenbrook labels from Graham Metropolitan PLC. Likewise, Chase used experts in set-backed finance, derivatives, loan syndication, and industry analysis to create a novel way for Houston Lighting & Power Co. to sell \$66.5 million in accounts receivable. "Nobody's suggesting we're all sitting

around and singing *Kumbaya*," says Joseph F. Sinzer Jr., a vice-president of global securities services. "But now, we have a lot more people talking about our customer, not my customer."

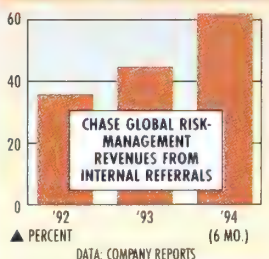
Similar changes are evident in private banking. Bernard J. Jacob, the head of M&A at Chase, recently set up a team to work on a \$20 million deal—too small for him to bother with ordinarily. But he did it to help Chase's private-banking unit build closer ties with an important client. Similar coordination is winning Chase business in securities-processing businesses such as global custody: Farmers Insurance Group became a global custody client this year after global-custody specialists coordinated with the private bankers selling investment products to the company.

STEEP TAKEOFF. The pickup in teamwork extends overseas. Asia head Timothy McGinnis says his group, working with corporate finance in New York, won a mandate to provide advisory work and financing to Philippine Airlines Inc. in 1993. The PAL business in turn helped

Chase win other work. The bank has added to its aviation and aerospace clients in Asia in the past year.

Remnants of old Chase ways remain: The office of Labrecque and the other executives on the 17th floor at Chase headquarters are still hushed, palatial spaces insulated

WORKING TOGETHER



the rest of the bank by uniformed
ds and glass doors that slide closed
lock at the push of a button. La-
que himself thinks the bank is at
halfway through its changes. And
e executives still need to be re-
led about communicating openly
other employees. Last year, Chase
ope's Thompson M. Swayne visited
bank's transaction-processing center

in the English town of Bournemouth—
where an employee's comment revealed
that Swayne was shutting people out
by delivering quarterly updates only
to bank officers. Swayne now sends
the reports to every employee in his
division.

As a Chase veteran, Labrecque is
acutely aware of how frustrated and em-
barrassed longtime employees have been

by the bank's problems—and how eager
they are to get Chase back on its feet.
In his view, if it takes sitting in a circle
and talking about conflict resolution,
that's fine. "You have to have been
where we were to understand," he says.
"People here like to win." Given time,
Chase just might.

*By Kelley Holland in New York, with
bureau reports*

RITIES FIRMS

OLDMAN'S DEEP BENCH MAY KEEP THE STREAK ALIVE

Corzine seems well suited to take over from Steve Friedman

on S. Corzine knows he has a very
tough act to follow. On Sept. 13, in
an announcement that stunned Wall
et, Stephen Friedman said he would
e at the end of November as chair-
of Goldman, Sachs & Co.'s manage-
t committee—in effect chief execu-
officer—and that Corzine would take
the position. Friedman
he is stepping down be-
e he is burned out by
job's intense demands.
iven, intellectual invest-
t banker, he led the pri-
partnership during the
prosperous era in its
near history. "I'd be cra-
I wasn't a bit appre-
ive," admits Corzine.

ut Corzine has two main
ngths that could make
the right choice to run
t many consider the
managed, most deeply
ed, and most profitable
on Wall Street: knowl-
e of the bond markets
an immensely likable
onality. "Jon can talk to
orate clients as well as
a trading operation.
s an enormously useful
ination of skills at Gold-
Sachs today," says Mi-
Salovaara, a former
man Sachs partner who
ow at Blackstone Group.

Corzine even gets kudos from compet-
such as Lehman Brothers Inc. Chief
utive Richard S. Fuld Jr., who
ked with Corzine on a Treasury Dept.
mittee that meets regularly with offi-
to discuss Treasury markets. "He
ws how to bring together groups with
erent interests," says Fuld. "He's a
ensus-builder."

he 47-year-old Corzine speaks as if

he will share the job, even though he
will clearly be in charge. Henry M. Paul-
son Jr., 48, will become vice-chairman
and chief operating officer. "We intend
to work as a true partnership. This is
not a one-person job," says Corzine in a
joint interview with Paulson, who seems
comfortable playing a supporting role.



CORZINE WILL GET LOTS OF HELP FROM A NEW NO. 2, HENRY PAULSON

The two men share a lot and comple-
ment each other. Both grew up in Illinois,
Corzine on a farm in Taylorville and Paul-
son in Barrington, where he still lives
on the 10 acres he bought next to his
parents and commutes to New York. Cor-
zine lives in New Jersey, with another
home on eastern Long Island. Both are
ex-college jocks: Corzine played basketball
and Paulson played football. As for dif-
ferences, Corzine is a Democrat and Paul-

son a Republican who worked for John
Ehrlichman in the Nixon White House.
And the bearded Corzine comes across as
a favorite cousin, while Paulson is more
reserved. "Stylistically, we're very dif-
ferent. He's a big, cuddly teddy bear. I
can't get people to look at me like that,"
says Paulson.

FULL DECK. Most important, the two
men's backgrounds mesh well. Corzine
started out as a bond trader and helped
build Goldman's dominant position in the
global bond markets. He also has been
the firm's primary risk manager and co-
chief financial officer. Paulson worked in
investment banking. Clients have includ-
ed Sears, Sara Lee, and Motorola. More
recently, he and Friedman managed \$2
billion of customer and firm investments
in real estate, Asian compa-
nies, and minority positions
in U.S. companies.

Corzine and Paulson will
have their hands full. Gold-
man, which prides itself on
teamwork and collegiality, is
under pressure. It is in the
midst of the excruciating
task of choosing about 40
partners from an unusually
large group. And after pre-
tax profits of \$2.3 billion in
1993, it earned just \$446 mil-
lion from December to May
because of some large losses
in markets that Corzine
supervised. The problem:
not calling the market down-
turn. "We didn't do it very
well. I blame it on myself.
We were not quick enough
to recognize that turn," says
Corzine.

Still, Corzine's longer-
term record of generating a
large chunk of the firm's
profits most likely got him
the job. But in trying to match Fried-
man's record, he and Paulson face what
they feel is a bleak market environ-
ment. Friedman thinks they're up to
the job. "They will derive the energy in
large part because they have an agenda
they want to accomplish and they want
to prove they can do it," says Fried-
man. With any luck, Corzine and Paul-
son will.

By Leah Nathans Spiro in New York

CALIFORNIA INSURERS KEEP FEELING AFTERSHOCKS

The quake hurt—and now some outfits are heading for the hills

When the Northridge earthquake hit on Jan. 17, it literally shook 20th Century Industries to its foundations. At the insurer's headquarters in Woodland Hills, Calif., power was out and phone lines were dead. Within 72 hours, the company had set up a makeshift camp in its parking lot and was processing claims from the 150,000 Los Angeles homeowners that it insures.

Residents are rebuilding their city. But for 20th Century and other insurers in California, the ground is still shaking. They're beset by irate homeowners, realtors, and regulators—not to mention huge loss claims. Crippled by excessive concentration in the areas hardest hit by the earthquake, 20th Century on Sept. 8 raised its estimated payout from the quake to \$815 million from \$685 million—raising concerns about the company's survival. Worse yet, fearing similar fates, casualty insurers are stampeding for the borders, which could further weaken the state's sluggish economy.

WRITERS' BLOCK. Over the past few months, insurers of more than 60% of the state's homeowners, including 20th Century's insurance units, have either left or stopped writing new business. "We are in the early stages of a full-blown insurance availability crisis," says state Insurance Commissioner John Garamendi. State Farm Insurance Group, the leader, with 21% of the market, will write a new policy only when an old policyholder leaves. Allstate Insurance Group and Farmers Insurance Group, No. 2 and No. 3, are not writing new policies—period. Others are tightening requirements.

This in turn could produce a homeowner backlash. Policy cancellation notices are expected to hit consumers in



SHAKY GROUND: HOMEOWNERS HAVE FEWER INSURANCE OPTIONS

force this fall—just as state legislators are campaigning for reelection. Garamendi will hold hearings Sept. 28-29 on the crisis.

The cancellations have the state's realtors up in arms. To them, the insurance pullout threatens to crimp the nascent housing recovery. Pat Neal, president of the California Association of Realtors, sees the exodus as a political ploy—an attempt to pressure legislators to overturn a California law requiring insurers that sell lucrative homeowner coverage also to provide risky earthquake coverage. "It's blackmail," she says. "Even with a 4½-year recession,

we're still the eighth-largest economy in the world. Do you think they'd get this up?"

Insurers also have to deal with Garamendi, a longtime foe, who is trying to figure out how to keep them in the state. He says he'd be willing to lift the earthquake requirement if insurers contributed to an earthquake-insurance pool to provide coverage for those who could not otherwise find it. A federal bill that would accomplish the same thing on a nationwide basis is moving too slowly through Congress to help California.

RISKY RATIO. Meantime, Garamendi's office is battling Farmers Insurance, which raised its earthquake deductible for most of its California policies from 10% to 25% of insured value on July 15. Garamendi's staff contends that such a high deductible amounts to a refusal to write policies. And 20th Century is tussling with Garamendi's office over the \$18 million it's required to refund to policyholders under Prop 103's 1988 premium rollback.

The \$119 million refund, which a state court upheld in August, is just one of 20th Century's problems. Its premium-to-surplus ratio, a solvency measure regulators use, has dropped to at best 8 to 1, far below acceptable levels of 3 to 1. Long term, the company, which has been one of the most successful auto-policy writers in the state, will either have to sue stock or find an outside investor. But even that will be tough: Rating agencies recently cut its debt rating, causing the stock to lose 25% of its value.

As 20th Century struggles to survive, it stands as one more reminder of the devastation of the quake. The repair work is still ongoing at its headquarters. But it will take more than glass and concrete to strengthen the shaky bonds that now link California to its skittish insurers.

By Nanette Byrnes in Los Angeles

HUNKERING DOWN

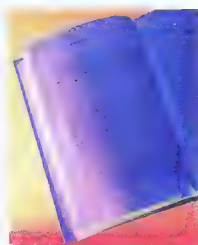
Homeowner policy writing status of 10 largest California insurers

Company	Market share*	Status	Company	Market share*	Status
STATE FARM INSURANCE GROUP	21.3%	Replacement policies only	UNITED SERVICES AUTOMOBILE ASSN.	3.0%	Still writing
ALLSTATE INSURANCE GROUP	17.3%	No new policies	SAFECO INSURANCE	2.7%	No new policies
FARMERS INSURANCE GROUP	13.4%	No new policies	FEDERAL INSURANCE (CHUBB)	2.5%	Still writing
CALIFORNIA STATE AUTO ASSN.	4.1%	Still writing	20TH CENTURY INSURANCE	2.2%	Withdrawing completely
FIREMAN'S FUND INSURANCE	3.1%	Still writing	REPUBLIC INSURANCE GROUP	2.0%	Withdrawing completely

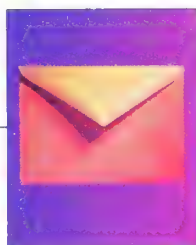
* Market share percentages based on 1992 premiums

DATA: CALIFORNIA INSURANCE DEPT.

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COMPUTERS, COMMUNICATIONS, MICROELECTRONICS

BY GENE G. MARCIAL

WILL MANOR CARE SPIN OFF CHOICE HOTELS?

Growth potential alone won't make Ron Baron buy into a company. "We also have to like the business it's in and the management," he says. If it's also way underpriced, so much the better. That's why his Baron Capital Management has bought 1 million shares of Manor Care, one of the largest U.S. nursing-home companies.

Manor Care is unusual: In addition to 163 homes in 28 states—plus one acute-care hospital in Texas—Manor Care owns Choice Hotels International, a worldwide franchise with 3,200 hotels and motels operating under such names as Quality Inn, Econo-Lodge, Comfort Inn, and Friendship Inn.

Whispers say the company will take Choice Hotels public "sometime soon—certainly this year"—by selling 20% to the public and distributing the rest of the shares as dividends to Manor Care shareholders.

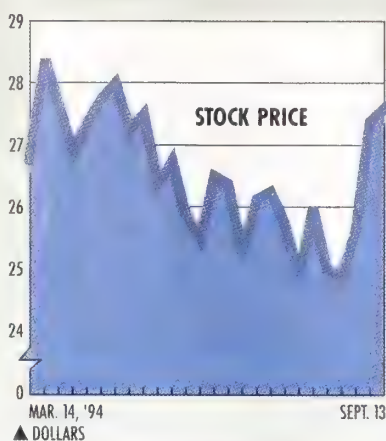
Manor Care stock closed at 27% on Sept. 13. But Baron reckons just the hotels—franchised and company-owned combined—are worth \$20 a share. Together with the nursing homes, estimated at \$21, and the division that manages Manor Care's properties, worth \$15, Baron calculates the company's total value—net of debt—at \$56 a share.

EXTRA BEDS. Manor Care is benefiting from a hotel turnaround, notes Baron. He sees Choice Hotels' franchise revenues—\$161 million for the year ended May 31, 1994—jumping to \$193 million next year. He puts the value of the franchised hotels at \$650 million, or \$12 a share. The company-owned hotels, which generated revenues of \$78 million in fiscal 1994, should climb to \$104 million. Baron values this group at \$500 million, or \$8 a share.

The nursing-home business should stay strong, analysts figure, producing revenues of \$923 million in fiscal 1994. Baron reckons revenues will increase to \$1.1 billion this fiscal year and \$1.2 billion in 1995. Revenue growth will be helped by additional nursing units and by the startup of facilities for patients with Alzheimer's disease.

Baron figures Manor Care will earn

MANOR CARE MAY STILL BE WAY UNDERPRICED



\$1.67 a share in fiscal 1995 and \$2.13 in 1996, up sharply from 1994's \$1.29. His estimates don't yet reflect any changes in the structure of the Choice Hotels business. Manor Care Treasurer Jim MacCutcheon says separating Choice Hotels "is an idea we look at from time to time, but there's nothing we're prepared to announce at this point."

A RICE TRADER MAY START TO STEAM

Investment pro Doug Campbell is obsessed with finding the next *Teléfonos de México*, which he caught several years ago—before it zoomed from 24 to 65. Now, he thinks he may have another winner—in a most mundane business: Erly Industries, a rice miller and trader based in Los Angeles.

At first glance, the stock is a turn-off: From July 2, 1993, to Aug. 15, 1994, it was delisted from the NASDAQ for capital insufficiency. Iraq is a big customer, and the U.S. embargo on shipments to that country caused Erly a major loss.

But Campbell, president of D. A. Campbell Co., a securities firm in Los Angeles, thinks Erly is back on track. In the year ended Mar. 31, 1994, it earned \$17.6 million, or \$4.53 a share (including nonrecurring items) on sales of \$334 million—up 53% from the year before. Erly had posted heavy losses in the prior two years. In fiscal 1995's first quarter, Erly made 56¢ a share, on sales of \$121 million.

Erly deals in rice through a subsidiary, American Rice, whose stock, also

lately reinstated on the NASDAQ, trading at 4. American Rice, not Erly Chairman Gerald Murphy, has production capacity of nearly 2 million tons a year and operates big milling facilities in all the rice-growing regions: the U.S., the Caribbean, and Southeast Asia. The biggest export market for Erly is the Mideast, especially Saudi Arabia.

Campbell predicts sales of \$375 million to \$400 million in fiscal 1995 and earnings of \$1.50 to \$2. Campbell thinks the rice business is very interesting but much ignored on Wall Street. He says the stock, now at 8, could hit 12 to 15 in a year.

BRUNO'S COULD PROTEST TOO MUCH

Where there's smoke, there's fire. Some investors think that cliché may hold true for Bruno's, which operates 257 supermarkets in the Southeast. "Bruno's stock is about to catch fire," says a New York money manager, who believes a big food chain is considering a bid for the Birmingham (Ala.) company. Recently, industry takeover chitchat has had the shares seesawing between 7 and 9%.

On Sept. 12, the company strongly denied any such possibility, causing the stock to dip from 9% to 8%. But by Sept. 13, the stock was again on the rise, trading at 9 on heavy volume.

What's really going on? Analysts are nearly unanimous in pooch-pooching takeover rumors. "I'm convinced by management's categorical denial, and don't think the rumors are true," says Kay Norwood of Interstate/Johnson Lane. She has a "hold" recommendation on the stock. She thinks that, based on Bruno's lackluster fundamentals, the jump was unjustified.

But one big investor thinks the analysts are wrong—and insists Bruno's claim that nothing is going on means that "any takeover move will be hostile." This pro, who puts the buyout value of Bruno's at \$20 a share, thinks the company eyeballing Bruno's wants to bolster its presence in the Southeast, where Bruno's supermarkets—including Piggly Wiggly, Food World and Food Max—have a major presence. Sales totaled \$2.8 billion in the year ending June 30, 1994, and are expected to hit \$2.9 billion this year. Norwood figures Bruno's will earn 55¢ in the year ending June 30, 1995, up from 52¢ in 1994.



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THIS ADOBE ACROBAT HAS REALLY LIMBERED UP

Will Adobe's document-sharing software triumph on its second try?

We've all heard about the Information Superhighway—you know, where information will flow freely across far-flung networks to create a nirvana of digitized magazines, newspapers, and TV shows. But the truth is, when it comes to distributing anything more complex than E-mail, most of the world still resorts to printing. The hangup: Every word processing or desktop-publishing program uses its own fonts, typefaces, and formats for graphics. That makes documents nicer to look at, but they can be viewed in all their splendor only on a computer using the same software that created them.

So, when Adobe Systems Inc. introduced its Acrobat program for exchanging electronic documents in June, 1993, industry watchers heralded the product as the breakthrough that could open the electronic floodgates. Acrobat could take any document created by any software program—including a

four-color magazine page—and display it on any computer. The main Acrobat program would record a digital snapshot of the page in Adobe's Portable Document Format (PDF). Then, any computer equipped with a second Acrobat component, a "reader" program, could display the PDF image—just as it appeared on the machine that created it.

MARKETING MISSTEPS. By finally making paperless electronic publishing easy, Adobe had pulled off a technological coup. Some analysts predicted a billion-dollar business for Adobe within a few years. But marketing missteps and missing features capped sales at a paltry \$2.5 million in 1993. "It was a new area for Adobe, and they tripped all over themselves," says Chris LeTocq, an analyst with market researcher Computer Intelligence InfoCorp.

Enter Acrobat 2.0. On Sept. 12, Adobe took the wraps off a revamped version of the product that addresses many of the in-

ital shortcomings. For instance, Acrobat 1.0 allowed only limited searching. The 2.0 version includes a sophisticated "search engine" licensed from Verity Inc., which can sift through mounds of electronic documents, including charts, graphs, and captions, to zero in on specific information. And the new Acrobat has security features. Information publishers, for instance, can limit access, paying customers only.

But the bigger changes have to do with marketing. Adobe attempted to sell Acrobat as a "shrink-wrapped" package in stores. Now, the company will sell through systems integrators—experts such as Andersen Consulting that help publishers and corporations set up systems using Acrobat. The basic program starts at \$195 and a version for professional publishers is \$595.

Most important: This time, the reader program will be free. Publishers and online services can give it to customers, and Adobe is urging computer makers to bundle the reader with their PCs. The first to bite: Apple Computer Inc. "This should finally blow open the market," says William J. Caffery, a Gartner Group Inc. analyst.

It's potentially a vast market. Because electronic distribution is less expensive and more efficient than paper, professional publishers and corporations are taking a serious look. Carolyn Matmore, a vice-president at First City Corp., a supplier of research to broke-

GESCHKE: HE WANTS TO CAPTURE A MARKET THAT MAY SOON BE WORTH \$500 MILLION



ACROBAT'S TRICKS

- Converts electronic documents to a common format so they can be viewed and exchanged by anyone with the Acrobat "viewer" software
- Allows publishers to distribute information electronically while keeping the rich typefaces, graphics, and formats of printed documents

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age firms, says Acrobat "allowed us to get research reports off the paper and out of the mail." Switching to electronic can mean getting information out faster and saving millions of dollars in printing and postage. "Information will start to migrate at a blinding rate off paper and onto electronic," predicts Adobe Chairman and CEO John E. Warnock. And as that happens, the market for electronic document-exchange software could soar to half-billion dollars in just a few years, predicts Caffery.

Adobe isn't the only one eyeing the market. The company that sets the standard for electronic publishing stands to become a pivotal player when the Information Superhighway finally takes shape. A half-dozen small software companies, including Interleaf, Frame, Farallon Computing, and No Hands Software, have been selling document-exchange programs for a year or more. But not Adobe has more worrisome rivals. In July, networking giant Novell Inc. introduced Envoy, which it obtained with its acquisition of WordPerfect Corp. Novell plans to sell Envoy for \$189 by itself and will bundle it with its new PerfectOffice suite. Lotus Development Corp. also likely to jump into electronic document distribution.

LOOMING THREAT? Most ominous, there are rumblings of an Acrobat killer from Microsoft Corp. The software giant won't comment, but insiders say the company is working on an electronic document format and reader. If Microsoft includes a reader with future operating systems, it could dominate the market overnight.

The Microsoft threat may be years off, however. For now, Adobe has an edge: Hundreds of companies already use the PageMaker desktop-publishing package made by Aldus Corp., which Adobe acquired in a \$450 million stock swap on Aug. 31. That produced a \$500 million electronic publishing giant. Aldus' PageMaker and Adobe's PostScript "page description" software are widely used by publishers. That, says Adobe President Charles M. Geschke, makes Acrobat, which is Postscript-compatible, a natural choice for electronic delivery.

Adobe has already signed some big names for Acrobat 2.0, including The Associated Press, which will use it to download advertisements to member newspapers, and Equitable Life Insurance Co., which will use the software to manage corporate documents. "We see an opportunity for us and our customers to move into the electronic age," says Geschke. If Acrobat has really learned its new tricks, that is.

By Amy Cortese in New York

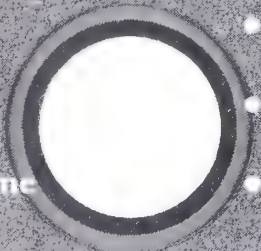
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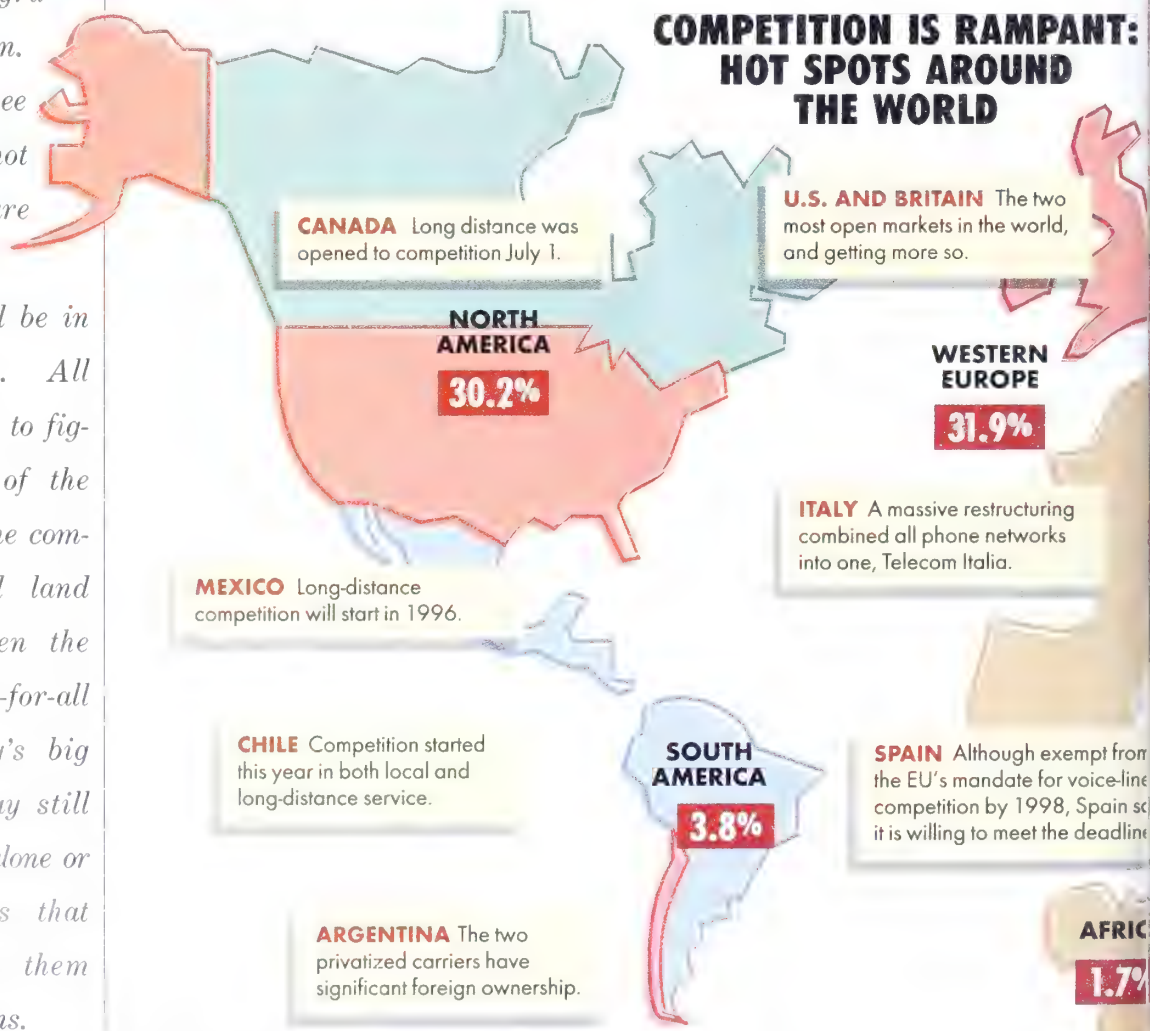
Draw a map of the world based on the distribution of phone lines, and you'll get a new kind of geography lesson.

It's easy to see where the hot markets are now and where they'll be in the future. All that's left is to figure which of the world's phone companies will land where. When the global free-for-all ends, today's big carriers may still be on top—alone or in alliances that will make them telecom titans.

If you buy a pair of tennis shorts from New Jersey-based Sportif USA Inc., chances are the label will say "Made in Sri Lanka." That's because in 1992 the late Sri Lankan President Ranasinghe Premadasa issued an edict outlining the steps his nation's garment factories would take to compete with other Asian producers. A top priority: In a country with only one phone line for every 200 people—among the lowest ratios in the world—Premadasa required that every factory have two:

one for a phone, a second for a fax machine. Fax machines in Sri Lanka, cellular phones in the Brazilian rain forest, satellite dishes in Russia, videophones in Manhattan—they're all part of a telecommunications revolution that, with blinding speed, is changing the way the world works. With high-capacity cables, digital switches, and satellites, a multinational corporation—or a t-shirt garment factory—can conduct business anywhere, anytime, searching out customers and suppliers around the world.

COMPETITION IS RAMPANT: HOT SPOTS AROUND THE WORLD



good measure of the globalized economy is explosion in international phone traffic. Overseas calling hit 47 billion minutes last year, up from 23 billion in 1988, according to the International Telecommunication Union (ITU). Each minute worth about one U.S. dollar to the world's carriers, that's a nice business to be in. International calling has been the fastest-growing segment of the telecommunications industry for a decade and will continue to be: ITU estimates that, as voice and data networks expand to reach millions of new subscribers and deliver more services to existing ones, revenues will hit 80 billion to 100 billion million per year by 2000.

FAST DRUMBEAT. To serve this massive market, the telecommunications industry is taking new form. An era of global business and global competition calls for carriers that can provide globe-circling services. "I don't want to have to pick up a bunch of different PRTs around the world," says William Donovan, vice-president of international technology for shipping giant Sea-Land Inc. "I don't want to have to go to one carrier in one country and a second in another because it doesn't have a presence there." E-stop shopping is only the start. From Paris to Beijing, businesses also are demanding state-of-the-art technology and reasonable prices—and they have an idea of how to get it: In the U.S. and Britain, nations that have gone the furthest in throwing off antiquated regulations, businesses see that com-

petition has improved service and cut costs. So liberalization, deregulation, and privatization are the watchwords *du jour*. "The customer is leaving regulators with little choice," says Lehman Brothers Inc. analyst Marianne G. Bye. "Some countries are moving toward free and open markets a lot slower than others, but they are all moving."

Phone companies, too, have little choice: Global competition is hitting them as hard as their customers. Even where governments still maintain protective barriers, the market is finding ways to skirt them. Around the world, businesses avoid high tariffs on outbound international calls by using call-back services, which re-route overseas calls so that they originate in the U.S., cutting costs by as much as 70%. Cellular phones are also grabbing business. "Wireless provides an opportunity for different operators to offer packages that provide the same services as the monopolies," says Pekka Alapietä, president of Nokia Mobile Phones.

Alternative suppliers, and a constant drumbeat for better service by customers, are convincing national carriers that it's worth giving up monopoly protection in return for freedom to compete. From the U.S. regional Bell operating companies, which are seeking to offer long distance, to Telekom Malaysia, which is looking to build an information superhighway in Kuala Lumpur—all are clamoring for the right to stretch beyond government-defined boundaries.

In the process, an unprece-

TELECOM TITANS

ATT: PICKING ITS TARGETS



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AT&T doesn't need to figure out how to expand its global reach—just where to focus it. "The biggest challenge for us is to pick the right opportunities for investment," says Chairman Robert E. Allen. In that respect, being the biggest can be a drawback: AT&T has found that most phone companies don't relish playing junior partner. So, instead of formal alliances, it has

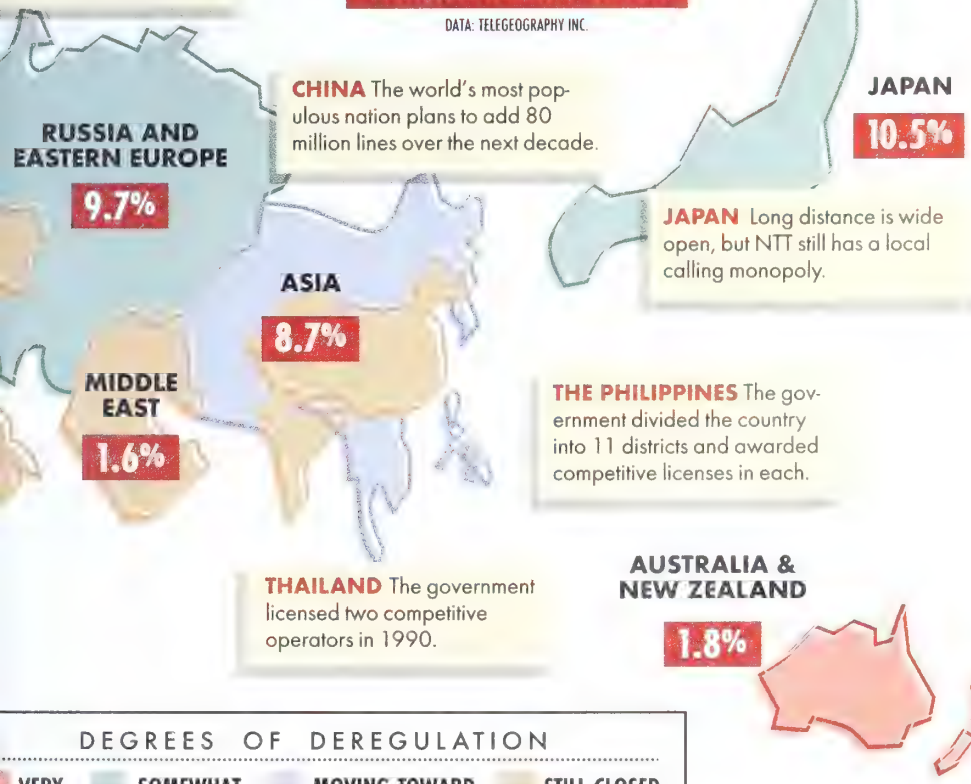
1993 REVENUES \$67.16 BILLION

formed WorldPartners Assn., a loose coalition of carriers offering corporate customers compatible data and voice services. Other members include Japan's KDD, Singapore Telecom, Telecom New Zealand, Australia's Telstra, Hong Kong Telecom, and Unisource, an alliance of Scandinavian phone companies.

DISTRIBUTION OF TELEPHONE LINES BY CONTINENT—1992

REGIONS SCALED TO NUMBER OF PHONE LINES

DATA: TELEGEOGRAPHY INC.



DATA: BUSINESS WEEK, LEHMAN BROS.

TELECOM TITANS

BT-MCI: POWERING UP



The combination of MCI Communications Corp. and British Telecom PLC certainly looks formidable on paper. Once BT completes its purchase of a 20% stake in the No. 2 U.S. long-distance carrier for \$4.3 billion, the first telecom mega-alliance will be unleashed. The two plan to pour \$1 billion into a joint venture offering around-the-world-network services to international corporations.

BT is the larger partner by far, with \$21 billion in revenues last year vs. MCI's \$11.9 billion. It carries 90% of the phone traffic in Britain, home to 14% of the world's multinationals. MCI, with 20% of the U.S. market, is a scrappy competitor known for innovative marketing. It has a \$2 billion plan to build a local phone network in 200 U.S. cities (to

1993 COMBINED REVENUES \$32.9 BILLION

snag corporate traffic), an alliance with Canadian long-distance carrier Stentor, and a joint venture in Mexico that plans to start a long-distance service there in 1996. But BT and MCI must smooth out cultural and corporate differences. And they need an Asian partner to match AT&T's clout in the region.

Special Report

dented free-for-all is redrawing the telecommunications map. Carriers everywhere are pushing overseas. "The guiding principle in the telecommunications industry right now is to grab territory," says Baring Securities Ltd. analyst Michael Jeremy.

Eventually, this could trigger massive consolidation and create an industry grouped around four or five superpowers. The list will almost certainly include AT&T; the alliance of British Telecom and MCI; the Sprint-Deutsche Telekom-France Telecom team; and Japan's NTT (tables).

In the meantime, it's every telephone company for itself: Nynex Corp. is building a cable-TV system in Thailand that will also carry phone calls. Telefónica de España, Spain's state-owned carrier, is paying \$2.02 billion for a 35% stake in two Peruvian phone companies. A Singapore Telecom affiliate is building a network in Manila's financial center. Tele Danmark paid \$7.8 million for a stake in two Hungarian phone companies. AT&T is helping to run a phone system in Ukraine, GTE Corp. is building a cellular network in Argentina, and Sprint Corp. bought 25% of a Canadian long-distance carrier. "In the 1990s, the vast pools of national telecommunications traffic, once a country's patrimony as much as its forests or its mines, have become the subject of fierce multinational bidding," says Gregory C. Staple, head of the Washington-based consultancy TeleGeography Inc.

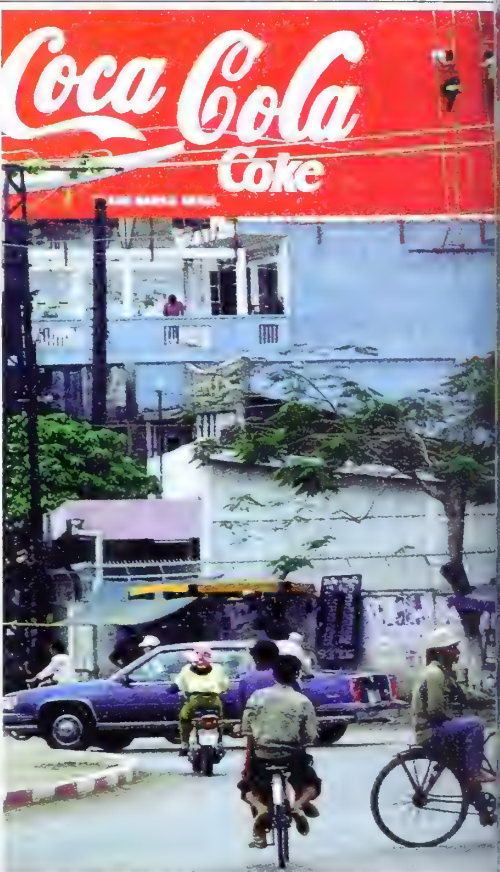
BOURSE DARLINGS. At the same time, state-controlled phone companies are moving to private ownership. Over the next two years, at least 36 nations will sell stock in all or part of their national carriers, an amazing rush to market considering that in 1993 only 17 international carriers had any private ownership. The trend is making telecom the hottest sector on bourses everywhere. Last year, for example, investors in most Latin American phone stocks doubled their money.

Governments also realize that selling the phone company is about the easiest money around. British Telecommunications PLC, the world's fourth-largest carrier, brought in a total of \$19.3 billion from three separate offerings that started in 1984. Even Denmark raised \$1.2 billion when it sold off a 48% stake in tiny Tele Danmark in April. Analysts say demand drove the stock price some three times higher than was expected for the \$2.75 billion-a-year carrier.

Privatization is now sweeping Europe, where the European Union has mandated deregulation of basic voice service by 1998. Last year, there were just three publicly traded carriers in Europe. By the end of 1995, 11 others are scheduled to be at least partially privatized. Lehman Brothers analyst Evan Miller estimates that the offerings could raise as much as \$13 billion. In 1996, says Miller, "we could see the mother of all privatizations—Deutsche Telekom." Deutsche Bundespost Telekom is the No. 2 international carrier, with revenues of \$35 billion last year.

Privatization and deregulation, though, don't guarantee market success. "Companies that have been monopolies for years find it very hard to change. We certainly know that," says Victor A. Pelsen, executive vice-president in charge of AT&T's global operations. Even if they suddenly sprout the gene for competition, most small carriers lack the resources to succeed on their own in a global market.

The quick solution: Partnerships, alliances and mergers. "You really can't deliver a tele-



com solution to a multinational company without partners," says Peter Kaliaropoulos, head of U.S. marketing for the Australian carrier Telstra Corp. Australia. Telstra is living proof of that tenet: belongs to seven joint ventures or consortiums, including AT&T's WorldPartners, a loose alignment of Asian and European carriers offering common products.

Phone companies everywhere are clamoring to pair up with leading U.S. long-distance carriers. AT&T, MCI, and Sprint offer global partners access to the most lucrative telecom market, home base for 40% of the world's multinational giants. "The consortium can be effective without a major U.S. presence, unless they want to become the equivalent of a regional airline feeder," asserts Seth D. Blumenfeld, group executive of external affairs for MCI Communications Corp.

YAKETY YAK



alliances can be much easier to propose than consummate. "Egos and economic self-interest always get in the way. Mostly egos," says Brian Thompson, chairman of U.S. long-distance company LCI International Inc. and a MCI executive. He and everybody else in the industry are carefully watching MCI's deal to offer a 20% stake to British Telecom. The two companies offer voice and data services across the globe to corporations.

MCI-BT link, as the first mega-alliance in telecommunications, is a test case for the future. Both BT and MCI are painfully aware of

deregulation, and once NTT is let loose, it is sure to be a powerful competitor—its \$3 billion annual research budget alone makes it a star attraction. "All the global alliances are knocking on [NTT's] door," says Telstra's Kaliaropoulos. "They can be a very, very key player."

Despite these telecom titans, the free-for-all will provide opportunities for small players, too. The global market could very well wind up looking like the U.S. long-distance market—in which three carriers have 85% of the traffic, while another 1,000 or so small fry make good money servicing the rest. "Technology is no longer a barrier to entry in this business," says Gabriel A. Battista, president of Cable & Wireless PLC's U.S. operation. "Third-party suppliers with some leased lines and specialized software could easily customize services for a tiny segment of the market and make money doing it."

For the moment, telecommunications does seem like a license to print money. The world's carriers raked in \$535 billion in revenues last year. The average net profitability of the telecommunications industry rose from 10.5% in 1988 to 14.9% in 1992, says the ITU.

CRYING NEED. Of course, profits could drop once phone companies feel the full effects of competition. But if the highly deregulated U.S. long-distance market is any measure, they won't. Soaring calling volumes have enabled U.S. carriers to rack up record revenues and profits, despite a 63% drop in the average price paid per minute over the past decade.

Around the globe, exploding demand should keep profits healthy. Industrialized nations are using more phone time each year, conducting business by voice, fax, computer network, and, soon, via videoconferencing and other multimedia methods. The rest of the world simply needs more phones. The ITU says 71% of the world's phone lines are located in countries with only 15% of the people. In

Latin America, only 7% of the population has access to a phone line. In most of Asia and Africa, it's more like 1%. In the U.S., though, it's 56%.

Throughout the developing world, governments are recognizing what Sri Lanka grasped: A modern telecommunications infrastructure is essential for economic progress. In the former Soviet Bloc, Hungary is jump-starting its decrepit phone system by licensing three cellular carriers, with the idea that they will get phones to a demanding populace now, while the newly privatized national carrier works on a long-term network upgrade. Vietnam is another good example: Despite a per capita income of \$220 a year, Hanoi is ordering 300,000 fiber-optic phone lines a year, routed by advanced digital switches. Leap-frogging to the latest technology could give

TELECOM TITANS

THREE-HORNED THREAT



If this mega-alliance goes through, it could lock up a major segment of the European market.

Deutsche Bundespost Telekom, Germany's state-owned phone monopoly, is the biggest international carrier in Europe and the second-largest in the world, with France Telecom, another national monopoly, right behind it. The two have a joint venture to service corporate customers; In June, they agreed to bring Sprint Corp. on board, paying \$4.2 billion for a 20% stake in the U.S. long-distance carrier.

Sprint wins big. A distant third in the U.S., it gets an inside track on French and German traffic. And despite its small size compared with its partners (Sprint had \$11.4 billion in 1993 revenues, France Telecom

1993 COMBINED REVENUES
\$69.4 BILLION

\$23 billion, Deutsche Telekom \$35 billion), the three will split equally any European business outside of France and Germany. Finally, Sprint gets a 50% stake from traffic in the rest of the world. One catch. The U.S. is likely to delay the deal until France and Germany open their phone markets.



VIETNAM: DESPITE LOW PER CAPITA INCOME, HANOI IS ORDERING 300,000 FIBER-OPTIC PHONE LINES A YEAR

links. The two companies, with combined annual revenues of \$33 billion, have been careful to spell out who gets to do what where. MCI will oversee marketing of the companies' services to businesses based in the Western Hemisphere, while BT will be in charge everywhere else. And MCI insists it will remain independent: BT has agreed not to increase its stake for 10 years, even if it were allowed to do so by a change in U.S. regulations, which now cap direct foreign ownership at 20%. Whether the alliance works or not, it has intimidated MCI's competitors to enter similar arrangements. Sprint has agreed to sell 20% of its stake to Deutsche Telekom and France Telecom, while AT&T has formed WorldPartners. And everyone's waiting to see what Japan's NTT will do. It's currently shackled by regulatory constraints that bar it from carrying international calls and force it to keep local rates artificially low. But Japan is creeping toward

NTT: 800-LB.
GORILLA

 Japan's Nippon Telegraph & Telephone is The Shadow of the global telecommunications scene. No one knows where it will go, but once it moves, it's sure to have a huge impact. For sheer bulk, it outclasses all other carriers. With a well-protected monopoly on local calls in Japan, the company's revenues reached \$60 billion last year. Its market capitalization tips the scales at \$129 billion, and with 232,000 employees, it's among the world's largest companies.

But NTT is weighted down with regulatory shackles. It is facing competition in the partially deregulated domestic long-distance market and is barred from carrying international calls. NTT President Masashi Kojima is agitating for freedom from regulation: If he gets his way, NTT's copious cash flow would

1993 REVENUES
\$60 BILLION

allow it to sink billions into partnerships. It has already invested \$80 million in an American wireless carrier Nextel Communications Corp., and it owns 20% of a Thai phone company. NTT has also signed with Microsoft, Silicon Graphics, and General Magic to provide multimedia services in Japan.

Special Report

it a big edge in attracting business. "Companies want to set up where the infrastructure is the best," says Lloyd Kubis, Motorola Inc.'s regional director for Asia.

There's still one big monkey wrench in the works, though. Digital technology may make it possible to send a fax halfway around the world in seconds. But government regulations can stop the transmission dead. In many places, the wheels of deregulation are grinding slowly. "One of our biggest problems [overseas] is that competition is still not prevalent in many markets," says AT&T Chairman Robert E. Allen. "Countries like France and Germany may talk about it a lot, but their markets are still closed to us."

SLOW PROGRESS. Old habits are hard to break. Ever since the invention of the telephone, the nations of the world have grown accustomed to controlling the way the instrument is used, owned, and profited by. State-owned phone companies, service monopolies, and artificially high tariffs have slowed the implementation of affordable, advanced telecommunications in all but a few countries.

But the high rates and slow technological progress that are the hallmark of state-owned carriers are now too taxing even for advanced economies. Companies in France, Germany, and Spain find it hard to compete when their phone bills are 15% to 50% higher than those of U.S. rivals. "Competition in telecommunications is today more urgent than European monetary union," says Bruno Lambroghini, head of research and strategy at Olivetti, one of Europe's largest companies. "Ask industry which they prefer. Industry is demanding a level playing field in telecoms above all."

It's easy to see why. A company doing business in Bonn spends an average of \$1,240 per month on telephone calls, while its London-based competitor spends only \$687, according to one industry study. A British survey found that in Germany the high-speed leased lines favored by businesses cost five times the going rate in the U.S. and twice the British average. Telecom fees for an international bank headquartered in Frankfurt can equal 30% of revenues, twice the amount a similar bank in New York shells out, the study found. That can make the difference between a successful global competitor and a loser.

European businesses are mad as hell and aren't taking it any more. Some of the continent's largest companies have banded together to press the EU for faster liberalization. A separate group of 30 large European companies, including Rank Xerox, Philips Electronics, and ICI, is taking matters into its own hands. It has hired a consortium

composed of British Telecom, AT&T, and several smaller carriers to develop a private trans-European network. With combined billings of some \$2 billion a year, the group's defection will sorely felt by the region's national operators. "Any country with its head screwed on right will advance the pace of deregulation [before 1998]," says BT Chairman Iain D.T. Vallance. "The alternative is to fall further and further behind."

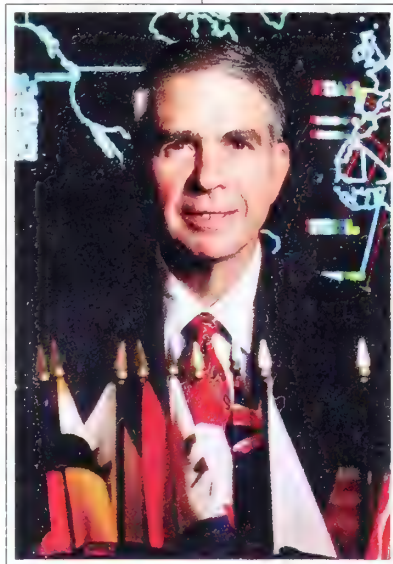
Europe, in other words, can no longer afford to pay lip service to liberalization. While the European Union has ordered competition in long-distance voice services by 1998, it hasn't decided whether competitors can start building their own networks. Says U.S. Federal Communications Commission Chairman Reed Hundt: "Europe has been a laggardly convert to privatization and remains a laggardly skeptic of liberalization."

Not for much longer. The state-owned carriers will soon be surrounded. Utilities, roads, and cable-TV companies are all proposed to develop phone services. In Britain, the electric industry is strung up phones lines between its pylons to form the country's third-largest long-distance network. On the Continent, Europe's carriers are planning a similar network.

The regulators are beginning to get the message. In Germany, one of Europe's most notorious deregulation laggards, government ministers and industry executives are preparing to discuss a faster timetable for telecom liberalization at a September meeting—in preparation for a similar meeting of European telecommunications ministers a week later. German Posts & Telecommunications Minister Wolfgang Bötsch just announced that he is inclined to end Germany's infrastructure

monopoly in 1998, when the voice-service monopoly expires. Once Germany goes, so goes the continent: Since it is the largest economy far in the EU, the other member nations are likely follow its lead.

WATCHING WASHINGTON. It is a sharp turnaround for Germany: The Posts & Telecommunications Ministry had resisted the EU on telecom deregulation for years. Why the change? Deutsche Telekom itself wants to be free of burdensome regulations. For one thing, its proposed alliance with Sprint may not go through unless the U.S. wrings some concessions from Germany to allow outside competitors. For another, the German carrier could soon be up against a powerful outside competitor: A consortium led by Deutsche Bank and Mannesmann, a leading industrial conglomerate, plans to lay private phone lines to bypass Deutsche Telekom altogether. The carrier can ill afford to lose its German-based market.



ROBERT ALLEN: AT&T'S CHIEF CAN'T WAIT TO MOVE INTO CHINA BUT COMPLAINS THAT, EVEN NOW, FRANCE AND GERMANY REMAIN CLOSED

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nationals at a time when it is laying the groundwork for its own place at the top of the global telecommunications heap—through its alliance with Sprint.

Besides, Deutsche Telekom need only look at Europe's own test case on liberalization to calm any fears it may have. Britain privatized British Telecom in 1984. It is arguably the most open telecom market in the world (sidebar), but BT

still carries 90% of Britain's phone traffic and is flourishing: fiscal 1994 profits rose 40%, to \$4.2 billion. Deutsche Telekom, by comparison, has had losses three years in a row, including \$1.85 billion last year. "I don't mind swapping a monopoly for a highly liberalized market where our share is a 'horrible' 60-80%," says Deutsche Telekom Chairman Helmut Rieke.

The world's phone companies are also

keeping a close watch on the U.S., which is about to embark on a bold new chapter in its own liberalization. Congress is expected to pass a bill by next year that will open up local and long-distance markets. The seven British Bells will be able to offer interstate services, while AT&T and its long-distance competitors will get to own local networks. Cable-TV operators, wireless-c

THE SPARRING MATCH BEING FOUGHT IN BRITAIN

It was door-to-door combat. Faced with losing thousands of customers a month to a cable company selling TV and phone service, British Telecommunications PLC sent 1,000 managers to Bristol this summer to knock on doors and offer special deals. But the plan may have backfired. The cable outfit, United Artists Communications Inc., says it's adding 3,000 phone customers a month—up 50% since BT's push.

Welcome to Britain, the land of telecommunications deregulation—and a warmup for the global telecom free-for-all. Since throwing its market wide open in 1991, Britain has licensed 146 companies to supply every form of service. It's the first country to allow competition in local phoning and the first to allow TV and telephone over the same wires—luring experimenters from across the world. "We're learning how to build the Information Highway here," says Eugene Connell, CEO of Nynex Corp.'s British cable unit.

The result of all this experimentation? Faster deployment of new technologies, a giant prod to BT to improve service and lower prices, and—above all—freedom of choice. "The kind of problem the telecom manager faces now is a bewildering choice of services and providers," says David Harrington, director-general of the Telecommunications Managers Assn.

Just 10 years ago, Britain's telecommunications was BT, period—a sluggish state monopoly. Privatization in 1984 was followed by a seven-year duopoly with Mercury Communications Ltd., a unit of Cable & Wireless PLC.

Now startups and corporate carpetbaggers have opened shop. Energis, owned by 12 regional electric companies, offers phone service over a 2,000-mile fiber-optic network. Ionica L3 Ltd., backed by Yorkshire Electricity and Telecom Finland, plans to use cellular for the local portion of customer calls. An international mix of cable companies, Baby Bells, carriers, and media outfits are here, too. Nynex, Britain's No. 2 cable operator, has in-

tions Co. in Omaha, Neb., rolled out Europe's first advanced digital switch.

The competitors haven't grabbed lot of the \$18.6 billion domestic calling market—yet. The cable companies have only 500,000 phone lines, vs. BT's 26 million. But BT's share of the residential market has dropped to 94% from nearly 100% in 1991. Some 26,000 customers a month are switching to the cable operators and John Tyso, an analyst at Société Générale Straus-

Turnbull Securities Ltd., predicts that the upstarts could win up to 35% of the residential market by 2000. In business markets, Mercury has skimmed the corporate account, helping pare BT's share from 94% to 88% in three years.

HOBBLED GIANT? BT is not standing still. It's stringing more fiber-optic lines and has cut domestic rates by \$54 million since the start of the year. New phone lines are installed in days, not weeks. And almost all BT payphones work; during

the duopoly, something like 6 out of 10 were out of order at any given time.

BT is also pushing for relief from regulators that it says have gone too far. Still saddled with restrictions, the phone giant claims it could be handicapped in the global telecom fight. "In the U.K., the government has positively discriminated in favor of new entrants no matter how large and strong they are," complains BT Chairman Iain D.T. Vallance. Of course, when it comes to large and strong, BT is hardly slouch: Last year, it rang up revenue of \$21 billion and posted pretax profit of \$4.2 billion.

By Julia Flynn in London



ON THE HORN IN LONDON: TELECOM EXPERIMENTERS FROM ALL OVER ARE VYING FOR BUSINESS

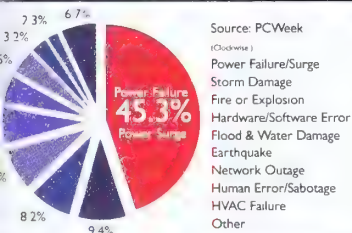
vested \$540 million and plans to spend up to \$3 billion by 1998. Telia, Sweden's national carrier, arrived this spring, and AT&T is on the verge of getting its British license.

To woo customers away from BT and Mercury, the new entrants promise better service, up-to-date technology, and low prices. Energis supplies detailed calling reports for business customers. BT, by contrast, still does not itemize bills for most of its customers—and bills them only once every quarter. Videotron Corp., a unit of a Canadian cable-TV operator, is offering a system that carries voice, data, and video. In February, MFS Communica-

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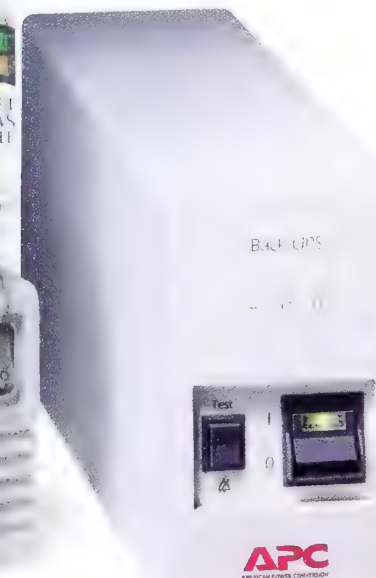
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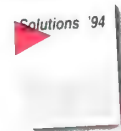
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munications services, and low-powered-satellite networks will be nipping away at both.

While all that is going on, the Clinton Administration is pushing hard for the telecom industry to build a national Information Superhighway that will carry interactive video and data as well as voice. That's something no other country is even close to developing. "The rest of the world is watching the U.S.'s infrastructure projects even more closely than the telecom legislation," says James E. Graf, vice-president for government relations at BT's North American opera-

in America is one of the great opportunities," says GTE Vice-Chairman Michael T. Masin. "The rate of growth exceeds significantly that in the U.S."

Ditto for Asia and the Pacific. Many Asian nations resist privatization but are opening up their markets to additional service providers, often foreign. It can be a great deal for the out-of-towners: Back in 1990, Ameritech Corp. paid \$1.2 billion for a 50% stake in Telecom Corp. of New Zealand, the island's main carrier. Even after selling half its share—for a \$136 million aftertax profit—the investment is still worth about \$1.2 billion.

century, at a projected cost of some \$1 billion. Beijing's goal is even grander: China says it will allocate \$100 billion to quadruple its phone network, to 10 million lines over 10 years.

CHINA DREAMS. Getting a piece of this action may not be easy. More than 60 foreign, local, and joint-venture firms have submitted proposals to help India expand, but not a single one has been accepted. Nor is there any indication when they will be. "And nobody among us is willing to wait forever," says a New Delhi-based executive of a U.S. telecom firm. China is almost as bad. The power



tions. "The world's carriers are very concerned that it will position the U.S. to move even further ahead on key facilities and services."

LATIN BONANZA. Meanwhile, local phone companies in the U.S. are pushing harder than ever overseas. Bell Atlantic Corp., for example, has made over \$2.5 billion in equity investments outside the U.S. since 1990, and its foreign cellular-phone networks cover populations 2½ times larger than its domestic systems. GTE generates about 11% of its revenues from overseas operations, most in South America, and plans to double that within the next five years. South American nations have been liberalizing their markets at a head-spinning pace, with five national carriers privatizing in the past four years. Now, the second stage is under way: allowing in competitive carriers. "We think Lat-

Less-developed Asian countries are even more eager for foreign investment. With only 25 million phone lines for 2.8 billion people in Asia's underdeveloped nations, "a new pragmatism has emerged," says Tele-Geography's Staple. "Governments generally recognize that they can't leave it up to [national carriers] to bring the network up to speed." It doesn't hurt that the World Bank, a major source of telecommunications infrastructure funding in the developing world, recommends open markets.

The biggest potential prizes in Asia are China and India—the world's two most populous countries, with the lowest penetration of phone lines. Both countries have ambitious modernization plans. In 1991, India said it wanted to add 40 million lines by the end of the

HUNGARY: THE LICENSING OF THREE CELLULAR CARRIERS MAY HELP JUMP-START ITS DECREPIT PHONE SYSTEM

By now, it appears that nothing can stop the Big Mo toward liberalization. The only question left: How will telecommunications map be configured once the dust clears? Any guesses made now wouldn't be very reliable. "If anyone can tell you what this business is going to look like five years from now, I want to find out what they've been smoking," says Allen. "I certainly don't know, but I'm sure it's going to be fun."

By Catherine Arnst in New York, with Gail Edmondson in Paris and bureau reports

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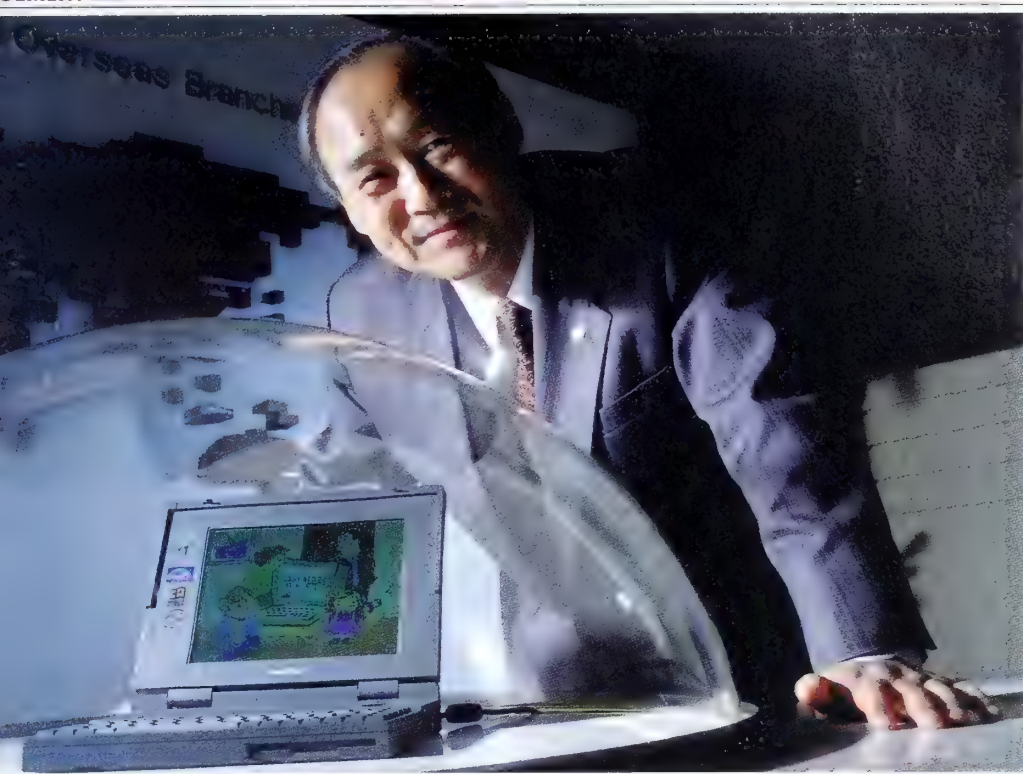
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GOLDSTAR IS TURNING BRIGHT

CEO turned the company upside down—and into a top player

was only five years ago that Goldstar Co. was in deep trouble. The largest South Korean maker of electrical appliances and consumer electronics had seen its market share slip at home and overseas, as product quality deteriorated. Losses piled up, margins evaporated and costs rose. "If we continue like this, we'll go bankrupt," wrote an impassioned worker in the company's bulletin. Today, the company is healthy and profitable. Goldstar is selling more in the rapidly growing Korean market while taking advantage of the strong yen to undercut Japanese competitors internationally. It has regained its No. 1 position in Korea for color TVs, refrigerators, washing machines. Globally, Goldstar has emerged as a powerful challenger in the fields of semiconductors and liquid-crystal displays. And it has formed alliances with such companies as Sony Electronics and GE Appliances

that will give it a boost in the U. S. and Europe.

The central figure in this transformation is Lee Hun-Jo, 62, who was appointed chief executive in February, 1989. The turnaround is typical of the metamorphosis many Korean companies are attempting. They are grafting more Western management techniques onto sometimes rigid Confucian-style hierarchies. And above all, they are attempting to move up the ladder from labor-intensive industries to battle the indus-

"You have to transform human beings. If you can't change your people, you can't change your organization"

trialized world's best technology companies. "We want to compete upward toward heaven," jokes Lee. "To compete downward is hell."

To do that, Goldstar was forced to shift its management from founding-family autocrats to professionals such as Lee, a 27-year veteran of the Lucky Goldstar group, the larger *chaebol* to which Goldstar belongs. Lee won near-complete control in 1991 when Chairman Koo Cha-Kyung made a guarantee of autonomy in writing and handed it to Lee before hun-

dreds of employees. Under the arrangement, Lee reports to Koo only twice a year on the company's performance. "I'm free to run the company the way I want," he says.

BRIGHTER NECKTIES. Lee has accomplished his transformation of Goldstar—whose annual sales are expected to reach \$6 billion this year—in part thanks to recommendations made by McKinsey & Co. But Lee, who speaks both English and Japanese, is also benchmarking his company against the likes of General Electric Co. and Motorola Inc. to learn about greater flexibility and customer orientation. All these changes have helped improve the company's quality record in the U. S., where a poor image has hurt its sales.

To challenge Goldstar's hierarchical culture, Lee sometimes resorts to almost missionary-like zeal. "You have to transform human beings," he says. "If you can't change your people, you can't change your organization. If you can't do that, you can't reach your goal." Lee's desk looks like a librarian's—piled with books in Japanese and English, including Tom Peters' *Liberation Management*.

Reflecting his thirst for change, Lee has broken with the tradition of conservative neckties and wears more brightly colored ones. He also refuses to sit in a designated seat of honor at meetings, just to throw managers off balance.

Goldstar under Lee has come a long

The Corporation

way since the summer of 1989. Labor disputes were spreading in all four of its Korean plants, inflicting \$600 million in losses. Rather than taking union leaders on as antagonists, Lee sought to close the communication gap by revealing as much financial information about the company as he could. He gave union leaders the unprecedented right to visit him at any time. Even rivals acknowledge how well Lee managed relations with the unions. "What is remarkable is that Lee, who rose to the top under the traditional top-down, owner-driven management, was able to wipe out whole layers of management between himself and the factory workers," says one executive at Samsung Electronics Co.

COOL CABBAGE. Having won workers' confidence, Lee was able to carry out his restructuring. With McKinsey's help, he reorganized Goldstar in late 1992 into nine strategic business units that include 29 operational groups. Each of these smaller divisions has a multidisciplinary team of designers, engineers, factory workers, and marketing people. The idea is to decentralize management as far down as possible, encouraging line managers, workers, and salespeople to open up the lines of communication among themselves.

Another challenge was to shake up the product-development process. In the past, in a bid to catch up with the Japanese, Goldstar once concentrated on bringing in a foreign product and reverse-engineering it. Although it allowed for some technology gains, it also kept the company permanently behind the cutting edge.

So Lee took what was seen as a radical approach: He let the engineers out of the laboratories and into the market to see for themselves what customers wanted. That resulted in a refrigerator that can keep Korea's national dish—

kimchi, fermented pickled cabbage or radishes—fresh and odorless for a long time. The fridge became an instant hit, helping Goldstar regain a No. 1 position in the domestic market, which it had lost to Samsung in the late 1980s.

Now that Goldstar has regained its lead at home, it is sharpening its focus overseas. It is shifting as much production as possible of low-end and midrange products to countries such as China and Vietnam. Goldstar now operates 14 overseas plants, including three new joint ventures in China. The company plans to increase the share of overseas production from the current 10% of sales to about 25% by 1997, a level comparable to that of Japanese companies.

In North America, the company has made strides both in driving down manufacturing costs and in improving quality—by shifting TV assembly from Huntsville, Ala., to Mexicali, Mexico, near San Diego. The combination 13-inch TV and VCR made there, called a TVCR, is one of the company's hottest-selling items in the U.S., where it retails for about \$329. Another new product winning good reviews is a VH8 playback deck, which allows fans of 8mm video to edit and transfer their home movies to a VHS format.

Overall, the company's U.S. consumer-electronic sales of

about \$1 billion in 1993 are growing at a torrid 17% clip this year, says Jeffrey P. Mullarkey, vice-president for marketing at Goldstar U.S. Inc. in Englewood Cliffs, N.J. Lee's reforms back home have had a "cascading effect" by persuading Goldstar factories in Korea and elsewhere in Asia to work more closely with U.S. design and sales units, says Mullarkey.

In high-technology fields, the company is relying on new alliances to increase market share. In 1991, it took 5% equity in Zenith Electronics Corp., creating a technology-development partnership. Suh

Yoon-Won, general manager for Goldstar's alliance coordination team, says the companies are developing high-definition and advanced picture tubes, engaging in a two-way flow of parts and technology.

Similarly, Goldstar has invested \$10 million in 3DO to work on the next generation of game hardware, and it's working with Oracle Corp. to develop video-on-demand set-top boxes. Goldstar also tied up with bigger U.S. companies: It's producing and marketing white goods with GE Appliances and developing new operating software with IBM. In all these alliances, Lee says Goldstar is trying to move beyond being merely a source of cheap production to become a full technology partner.

Of course, Goldstar still faces big challenges. The biggest single risk is its effort to develop thin-film transistor (TFT) liquid crystal displays, the next generation of the displays used in laptop computers and many electronic devices. The company plans to spend \$620 million to build a plant in Korea for making these 10-inch color LCDs. By 1997, the company says, output will reach 1 million units a year, making Goldstar a player in a market now 90% dominated by Sharp Corp. and other Japanese makers.

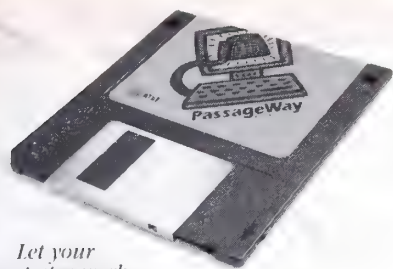
NATIONAL PRIORITY. Goldstar has one important advantage over Japanese competitors: The Korean government is behind its push into thin-film displays. Although a majority of the funding will come from its more lucrative white goods, the company can count on financial support from the government, which considers the new technology a national priority. "They are just as capable of nurturing this as anyone else," says Joseph Osha of Baring Securities (Japan) Ltd.

While its LCD effort hasn't yet paid off, Goldstar has succeeded against heavy odds in semiconductors. Goldstar Electron Co., of which Goldstar owns 62%, is the world's 10th-largest manufacturer of dynamic random-access memory chips. Goldstar joined hands with Japan's Hitachi to develop and market 1- and 4-megabyte DRAM chips. Today, the semiconductor company has a 5% share of the world memory-chip market and expects net profits to nearly double in the next two years, boosting Goldstar's earnings as well.

It's all a far cry from the dark days of 1989. Although Goldstar hasn't established itself as the equal of Sony or Motorola, it has made enormous strides. And even if Lee achieves only a fraction of his global aspirations, it's clear that Goldstar is competing upward toward heaven in many years to come.

By Laxmi Nakarmi in Seoul, with bureau reports





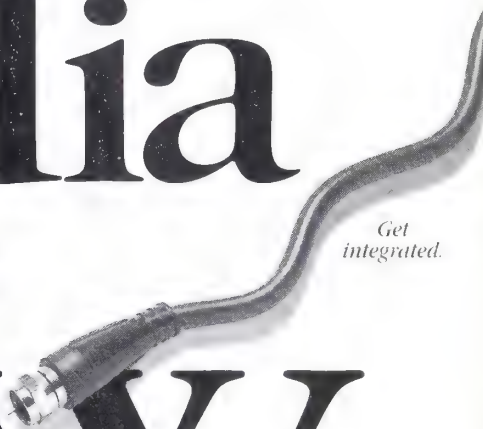
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THE EXPANDING UNIVERSE OF GLENN JONES

The quirky visionary goes where no cable mogul has gone before

Employee meetings at the Englewood, Colo., headquarters of Jones Intercable Inc. are hard to miss. "It's the sound of the bagpipes," says Robert Luff, the company's former chief technology officer. Summoned by kilted musicians, employees attend "state-of-the-fleet meetings."

That's fleet as in spaceships, reflecting the founder's fascination with the science fiction classic *Dune*. There's also the company's Medallion of the Alliance, awarded to employees who have achieved the rank of "dragon slayer" by beating back the fire-breathing challenges of the day.

TRUE NORTH. To the uninitiated it may sound less like a day at the office than one at a theme park. But to the faithful at Jones Intercable, the nation's seventh-largest cable operator, such corporate flamboyance is simply testimony to the entrepreneurial brilliance of founder Glenn R. Jones. The 64-year-old Jones, a onetime bomb-disposal expert for the U.S. Navy, is known as much for his offbeat enthusiasms as for making his \$683 million-a-year cable-television empire one of the most innovative in the industry. "Glenn's a dreamer, and sometimes that makes him seem a little different," says Bill Daniels, a Denver-based investment banker who specializes in cable TV. "But his dreams have turned out pretty well."

Indeed, driven by what Jones calls his "own North Star," his company was among the first to replace old-style coaxial cable with high-performance optical fiber and to secure a European beachhead. Both moves have since paid huge dividends. In July, Intercable folded its six British cable franchises into a company controlled by Bell Canada International Inc., getting in return a 14% stake in Bell Cablemedia PLC, Britain's largest public cable and telephone company.

Now, Jones is again pushing the frontiers. With the launch of tests offering telephone services to its cable customers outside Washington D.C. and Chicago later this year, Intercable is rushing to become the first cable outfit to counter

the wave of telephone companies that are moving to sell video services over phone lines. And Jones's ties to Bell Canada will soon grow exponentially. By yearend, federal approval is expected for BCI's December agreement to pay up to \$400 million for a 30% stake in Jones Intercable. The deal would give Jones access to BCI technology he needs to expand into phone and data services,

ly at the top of the list," says Sh. Stover, vice-president at cable Tele-Communications Inc.

The son of a Pennsylvania coal miner, Jones labored briefly as a lawyer before founding cable TV after an unsuccessful 1964 run for Congress as a Goldwater Republican left him \$40,000 in debt. In an oft-repeated story, he borrowed money on his beat-up Volkswagen for downpayment on a cable system. He served 150 homes in Georgetown, C. Borrowing again, he bought two more systems.

Then, he started dreaming bigger. He sat down and figured that it would cost \$10 billion to cable all of America, a figure he didn't have any way of getting much, he says. So, Jones copied deals common in oil and gas, becoming the first cable operator to find



"WHEN YOU TALK ABOUT VISION AND GETTING SOMEWHERE FIRST, JONES IS USUALLY AT THE TOP OF THE LIST," SAYS AN EXECUTIVE AT TCI

as well as provide the muscle to raise up to \$1.6 billion to buy new cable systems.

Jones has long excelled at deft management of cable systems. Far ahead of competitors, he saw the advantage of building systems in close regional clusters, concentrating on upscale suburban areas such as Northern Virginia and outside Chicago. Clustering cuts down on administrative and other operational costs. Jones's systems are also among the most technologically advanced, with fiber-optic cabling beginning ahead of the pack in 1989. "When you talk about vision and getting somewhere first, Jones is usual-

growth through what became a widely popular vehicle, limited partnerships. The partnerships, which paid fees to his company for managing cable systems owned by investors, shielded Jones from heavy debt. As rising valuations brought new investors, the network of cable systems Jones's companies own or manage has grown to 55, with 10 million subscribers.

Today, publicly held Jones Intercable and its sister company, Jones Space Ltd., have combined revenues of \$1.1 billion, up 15% from \$260 million in 1992, while the partnerships they manage have revenues of \$386 million. Like most cable operators, however, they

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money. Intercable and Spacelink together lost \$35 million in the fiscal year ended in May, while the partnerships lost \$73.3 million.

But in the cable-TV industry, reported losses matter little. Cable companies have enormous capital costs—and the partnerships are designed to give tax losses to investors. More important than producing earnings has been Jones's ability to generate cash flow needed to fund expansion and upgrade systems with fiber-optic cable. Still, the complex web of partnerships and the relatively thin trading of its stock have hurt Jones's tightly controlled public companies on Wall Street. "It's just not worth the time it takes to understand it," says Kidder, Peabody & Co. analyst Alan

Gould, who follows one of Jones's partnerships.

The complexity hasn't hurt Jones, however. He has amassed a fortune estimated at more than \$300 million by holding huge blocks of both Intercable and Spacelink, as well as a controlling stake in Jones Space Segment, a private company that generates millions from the operating companies by leasing satellite transponder space. A few years back, Jones Intercable also paid its chairman \$4.3 million for his stake in Jones Galactic Radio, which provides stereo music to cable subscribers, while other private companies owned by Jones provide data and financial services and arrange deals for the public cable companies.

Jones's deal with BCI is expected to simplify the structure, giving the company more allure on Wall Street. Intercable and Spacelink will be merged in many of the investment partnerships bought out. Although the deal will dilute Jones's personal stake in the merged companies to 35%—he currently controls 86% of Spacelink and 48% of Intercable—it will give him the funds to go shopping for more cable systems. He'll also pour more money into his longtime infatuation, Mind Extension University. Jones spent \$30 million of his own to launch the seven-year-old cable university, which offers college courses to some 1 million cable homes.

For Jones, a voracious reader who employs a full-time staffer to summarize

JONES'S JEWELS

1993 PROFIT OR LOSS ▶

1993 REVENUE ▶

DATA: JONES INTERCABLE

JONES SPACELINK™

Controls 86% of operator of cable-TV systems; manages cable partnerships with revenues of \$41.6 million

▶ -\$10.4 million

▶ \$166.9 million

JONES INTERCABLE™

Controls 48% of cable operator; also manages cable partnerships with revenues of \$344 million

▶ -\$25 million

▶ \$132.4 million

MIND EXTENSION UNIVERSITY

Has a 51% stake in this provider of higher education programming received in 26 million cable homes

▶ Not available

▶ \$10.8 million (estimate)

JONES SPACE SEG

Wholly owns this private company that leases time and transponder space from other Jones companies

▶ Not available

▶ \$2.4 million

* Pending merger between Spacelink and Intercable followed by Bell Canada International's acquisition of a 30% stake would reduce Glenn Jones's control to 35% of combined company by year 2000.



The Action.



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Slip a Philips Digital Video Cartridge into a Philips Compact Disc Interactive Player (CD-i). Your television comes alive with full-motion interactive games, educational and music videos, even movies. And you're right in the middle of the action.

s for him, education is a mantra. He insists the money-losing Mind Extension University is also a business making; he is currently launching new channels with courses in comics, foreign languages, and health. Jones plots his empire's next move in a building just outside Denver that is designed to give employees a grand view of the Rocky Mountains. The wall in the atrium, he admits, was inspired by a scene from *Dune*. His office includes a "war room" with a confetti of TV screens and electronic devices that would do the *Starship Enterprise* proud.

In question about it, there are few executives who do things quite like Jones. Writing as "Yankee Jones" in a series of books he has published called Briefcase Poetry, Jones might be talking of himself in a poem entitled *Entrepreneur*: "The dreamer is a practical man, he can do things no one else can." And now he has the cash to turn more of his dreams into reality.

*By Ronald Grover
in Englewood, Colo.*

HOW TO ROPE 'EM WITH PLASTIC

Orioles fan? Penn State alum? MBNA has a card for you

When Texas A&M University fans gather at Kyle Field for another season of Aggie football this fall, they'll stock up on pennants, jerseys, and other souvenirs proclaiming their fidelity to the gridiron athletes. But this year at the College Station stadium, they'll also have a chance to sign up for a very different tribute to their alma mater: a MasterCard emblazoned with the school's maroon "T" symbol.

Sure, wallets are already thick with plastic, and consumers are being inundated with credit-card solicitations. But appealing to school spirit to find new charge-card customers is turning out to be canny marketing. Thanks to "affinity" programs such as the one it offers through Texas A&M, MBNA Corp. has become the fastest-growing issuer of credit cards in the nation, with some 14 mil-



**MBNA "AFFINITY CARDS":
UPSCALE MEMBERS, FEWER DEADBEATS**

lion Visa and MasterCard customers.

College football fans aren't the only ones flashing MBNA-issued cards, each customized with its own logo. Among the bank's newer clients: members of the National District Attorneys Assn. and



The Hero.

The muscle behind the Philips Digital Video Cartridge is the Motorola MCD251 Full-Motion Video Decoder. It creates an interactive viewing experience of heroic proportions. From CD-i players to remote controls, products powered by Motorola are fast becoming a way of life.



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Microcontroller Technologies Group

The Corporation

fans of the Baltimore Orioles. "We've gone into a commodity business and issued a card that's not a commodity," says Alfred Lerner, MBNA's 61-year-old chief executive and the bank's biggest shareholder, with a 12.2% stake.

That has quietly turned the once-tiny bank, based in Newark, Del., into a powerhouse in the card industry. With \$16 billion in loans outstanding, its bank-card business is second only to Citibank's, with \$34 billion. Its earnings growth has been stellar, too. MBNA's profits could rise 27% this year, to \$264 million, figures analyst Mark T. Lynch of Lehman Brothers Inc.

SCREEN TESTS. MBNA has been the leading purveyor of affinity cards since it was founded in 1982 as the credit-card unit of MNC Financial, a Baltimore bank. In 1991, it was spun off in a public offering to raise money for its parent, which was ailing from the real estate downturn. The sale was part of a strategy by Lerner, a Cleveland real estate investor and a big MNC shareholder,

who was brought in to rescue the bank. MNC has since merged with NationsBank. Lerner, who spends most of his time in Cleveland, has remained CEO of MBNA. President Charles W. Cawley handles MBNA's daily operations.

Using a master list of 35,000 organiza-

card programs with 3,600 organizations

Thanks to that careful screening MBNA boasts one of the most affluent customer bases in the bank-card industry. And that means fewer deadbeats. So far this year, only 2.7% of MBNA credit-card loans were written off as

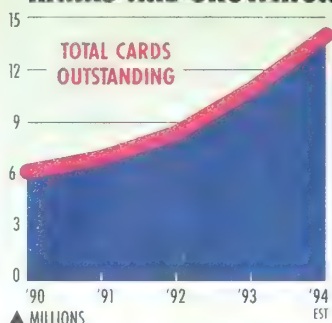
collectable, compared with an industry average of 6% and 5.3% at Citibank.

Once a group is selected, MBNA offers the organization a share of the credit billings to secure its endorsement, along with a membership list and a right to mail solicitations on the group's letterhead. For example, the Sierra Club receives 0.5% of every charge made by the 45,000 members who carry MBNA cards. This year, proceeds for the environment

group will top \$400,000. The financial turn to a group is a potent lure in signing up cardholders. So are sentiment and pride of affiliation, says Lerner.

Service is also critical in keeping customers happy, given the proliferation of card enhancements in recent years.

MBNA'S CARDHOLDER RANKS ARE GROWING...



...AS ITS AFFINITY PROGRAMS MULTIPLY

MBNA offers Visa and MasterCard through 3,600 organizations.

Among its customers:

- ▶ Telephone Pioneers of America
- ▶ American Legion
- ▶ National Education Assn.
- ▶ Sierra Club
- ▶ Chicago Bulls
- ▶ Carnival Cruise Lines
- ▶ Brown University Alumni

DATA: THE NILSON REPORT, COMPANY REPORTS

tions in the U.S., MBNA marketers scout out groups with an upscale membership, such as professional societies and college alumni associations. Texas A&M, for instance, is among 315 colleges and universities that promote MBNA's cards. Altogether, the company has affinity-



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and show up at ma-
nctions. And they use
contacts to drum up
business through sub-
at mailings and tele-
ting. Such efforts pay
hen Mellon Bank Corp.
e Penn State Alumni
account, it signed up
5,000 cardholders be-
BNA took over the pro-
in 1989. Since then,
has built it to 120,000
ts.

LEAN PLAN. Meanwhile,
is chasing new audienc-
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dents of all 50 states, as
s some municipalities.
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on surnames and their coats of
In each case, MBNA depends heav-
credit reports to select the most
t customers. Such cards now ac-
for half of MBNA's new cardholders
ear, vs. 30% two years ago. The
traction for MBNA: There's no or-
tion to share billings with. Mean-
since last November, the company
een pitching cards in Britain
h outfits such as the Rolls-Royce
siasts' Club. MBNA marketers plan



LERNER AND CAWLEY PITCH THEIR CARDS AS PREMIUM PRODUCTS

to enter the rest of Europe by 1997.

Despite the popularity of its cards, MBNA has been criticized by some consumer watchdogs for peddling an expensive method of demonstrating group loyalty. The bank charges an average interest rate of 16.1%. That's shy of the 17.6% average for all bank cards but nowhere near the bargain rates that have flooded the market recently. Wachovia Corp., for example, offers a card pegged to the prime rate, currently 7.75%. Moreover, though many issuers have stopped

charging annual fees, MBNA wants \$20 for a standard credit card.

MBNA could be forced to cut its rates and fees as competition intensifies. On Sept. 6, American Express Co. launched a new credit-card offensive by unveiling the Optima True Grace card, which offers a 25-day interest-free grace period on every purchase and a 7.9% rate for the first six months. And with plans to add perhaps a dozen new cards over the coming five years—some bearing the names of big retailers or other organizations—AmEx may nibble at MBNA's market.

"Consumers are saying they need something more than affiliation," says Ernest Berger, AmEx' vice-president for business partnerships.

For now, MBNA has no plans to alter its pricing formula. Cawley, MBNA's president, says the bank markets its card as a premium product, much as AmEx does its Green Card. The way Cawley sees it, consumers don't mind paying a little extra when they feel a real affinity for something.

By Joseph Weber in Newark, Del.

PHOTOGRAPH BY DAN LEVIN



The Chip.

The secret ingredient of the VCR PRO 4 is a Motorola 68HC05 microcontroller, which makes it possible to run everything without lifting more than a finger. From remote controls to engine controls, products powered by Motorola are fast becoming a way of life.



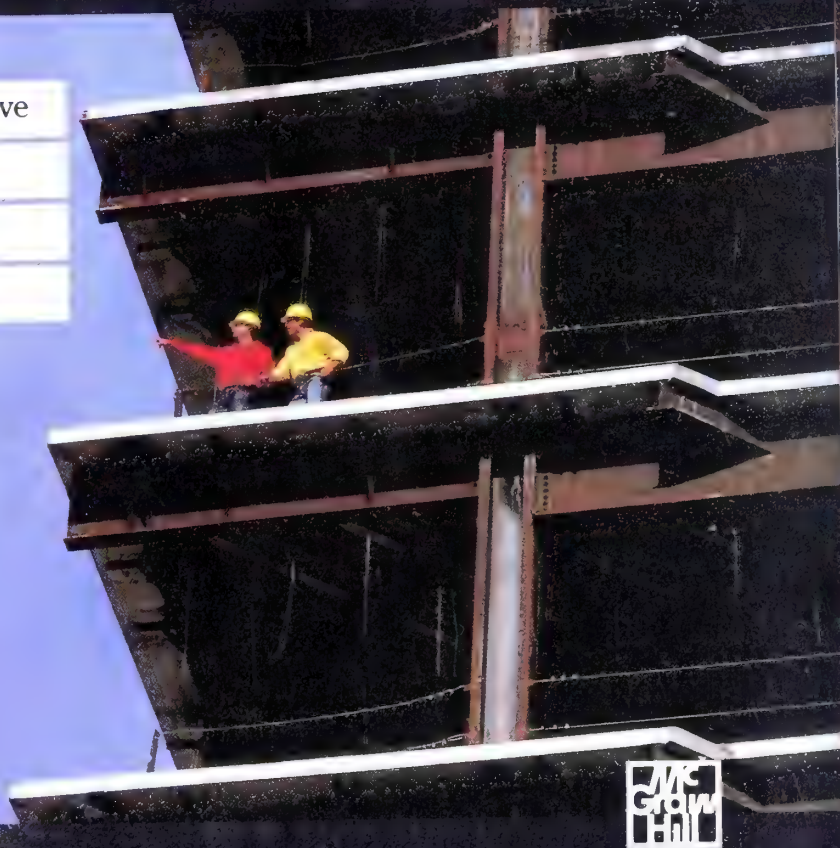
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The screenshot displays a software interface for 'Datapro on CD-ROM: Client/Server Analyst'. At the top, a menu bar includes 'File', 'Edit', 'Search', 'View', 'Options', and 'Window'. Below the menu is a toolbar with various icons. The main window is divided into several panes. On the left, a network diagram shows a hierarchy: 'Host 1' and 'Host 2' are connected to 'West Coast Region' boxes, which are then connected to 'Server' boxes. These servers are further connected to 'Office 1' and 'Office 2', each represented by a group of computer icons. On the right, a 'Table of Contents' pane lists various topics under 'Information Technology', including 'Systems Series: Overviews', 'Systems Series: Systems', 'Systems Series: Peripherals', 'Systems Series: Software', 'Development Software', 'Applications Software', 'Security', 'Servers & Software', 'Servers: Issues', 'Servers: Systems', 'Networking Systems', 'Computing Topics: Strategies & LAN', 'Computing Series: Distributed Databases', and 'Distributed Computing Concepts'. Below the Table of Contents, a section titled 'Solving the Client/Server Puzzle' contains text about client/server computing and a 'McGraw-Hill' logo.

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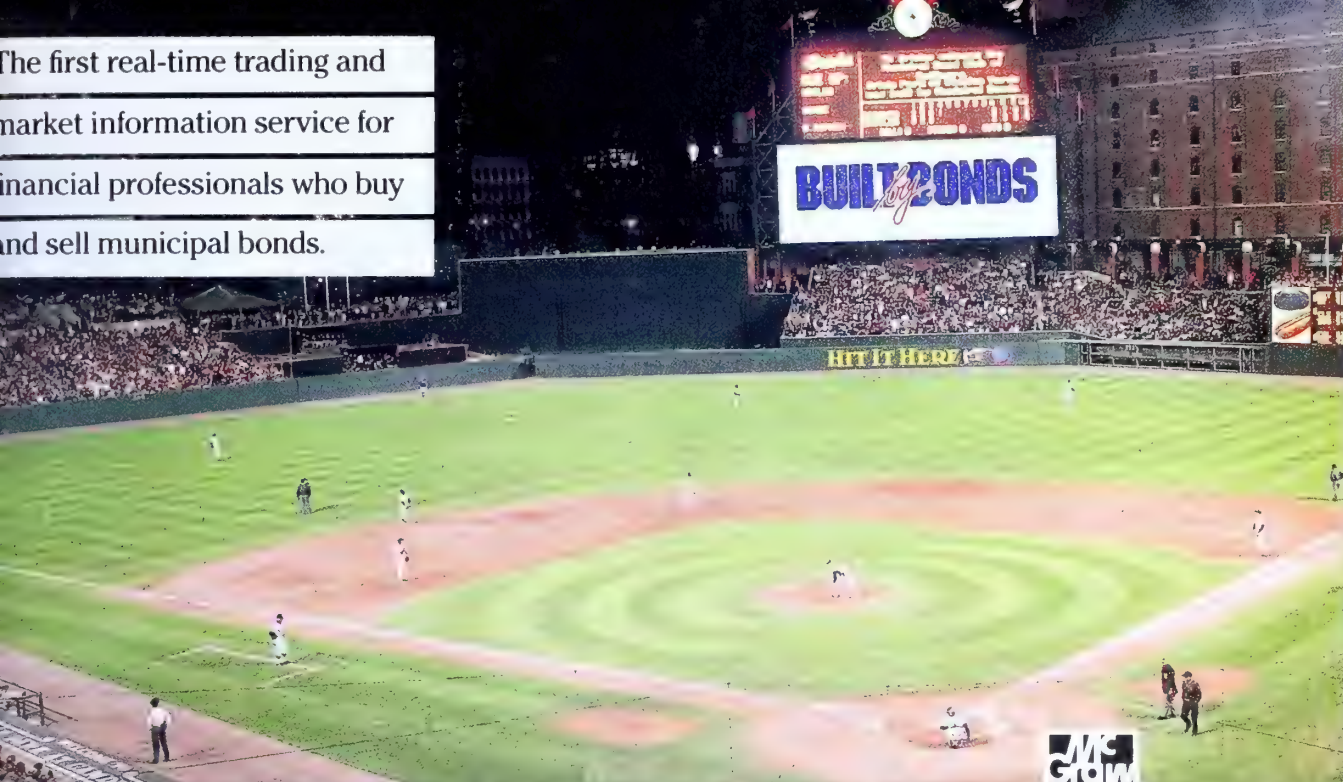


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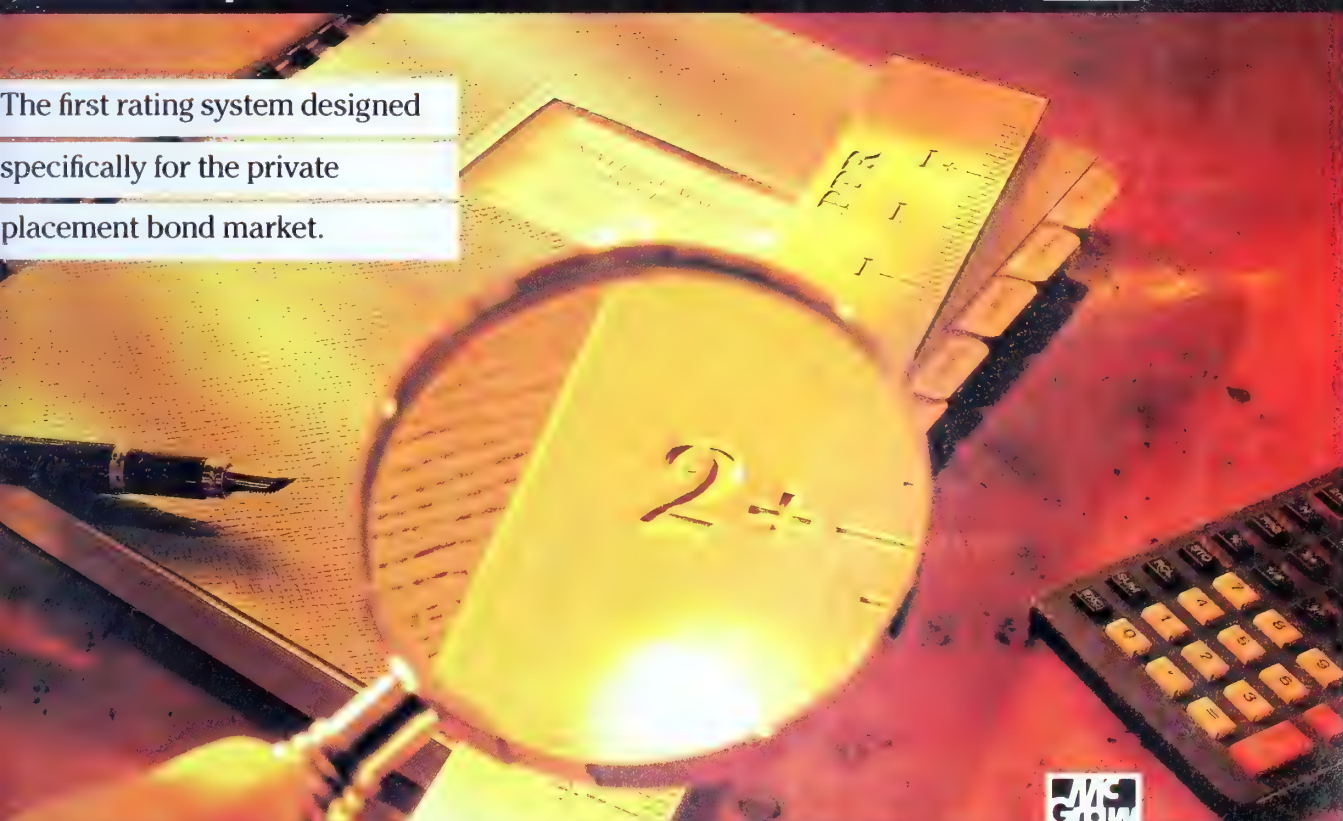


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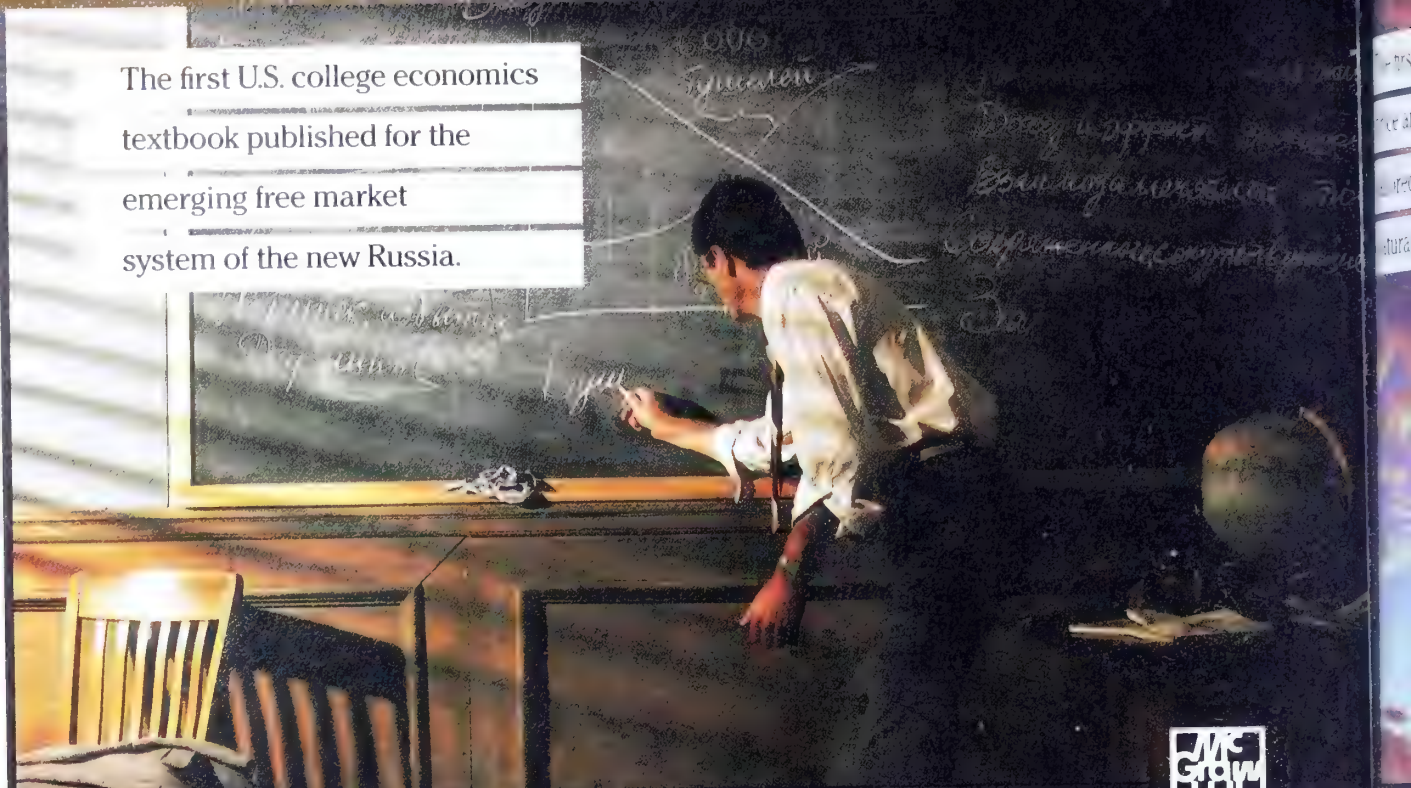


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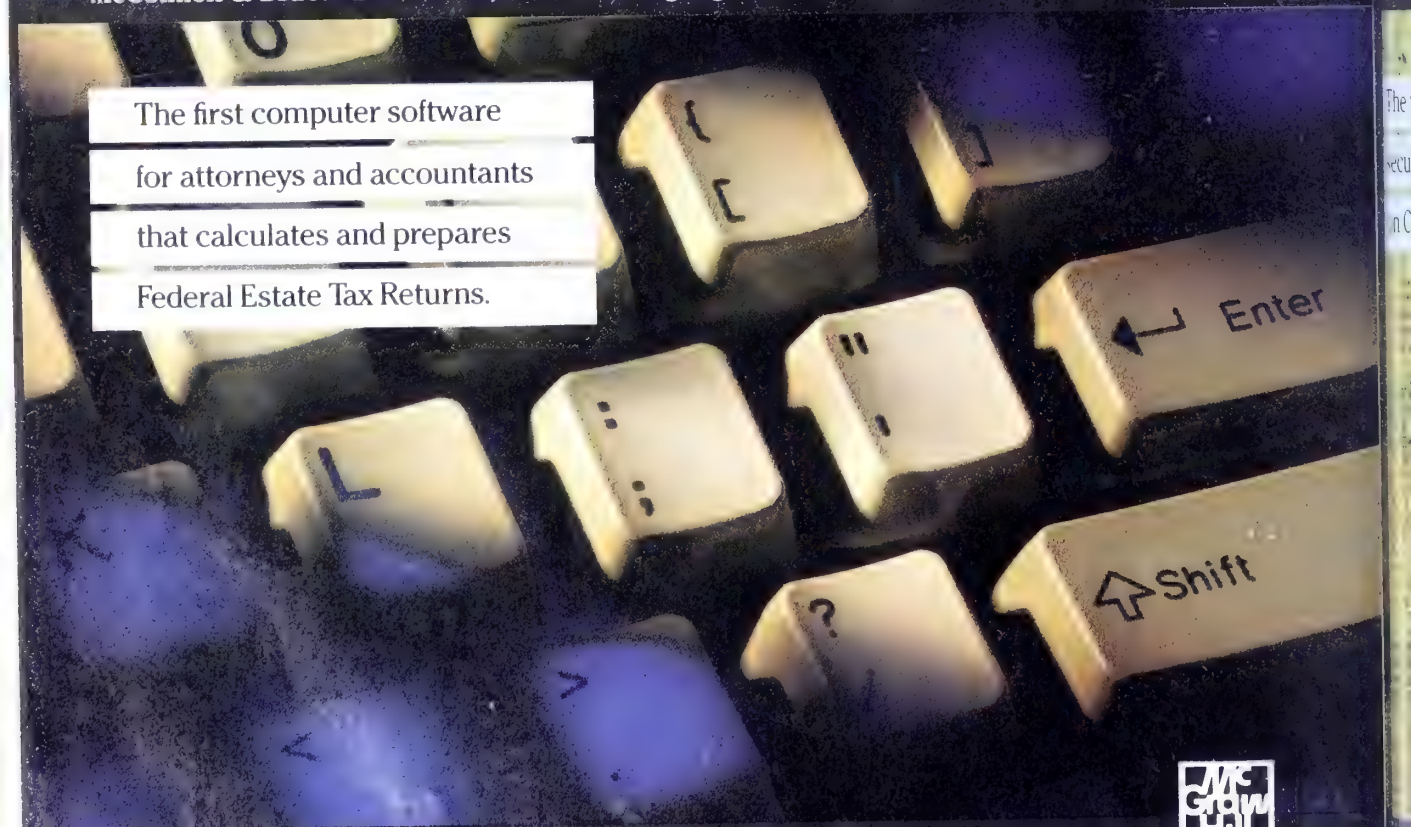
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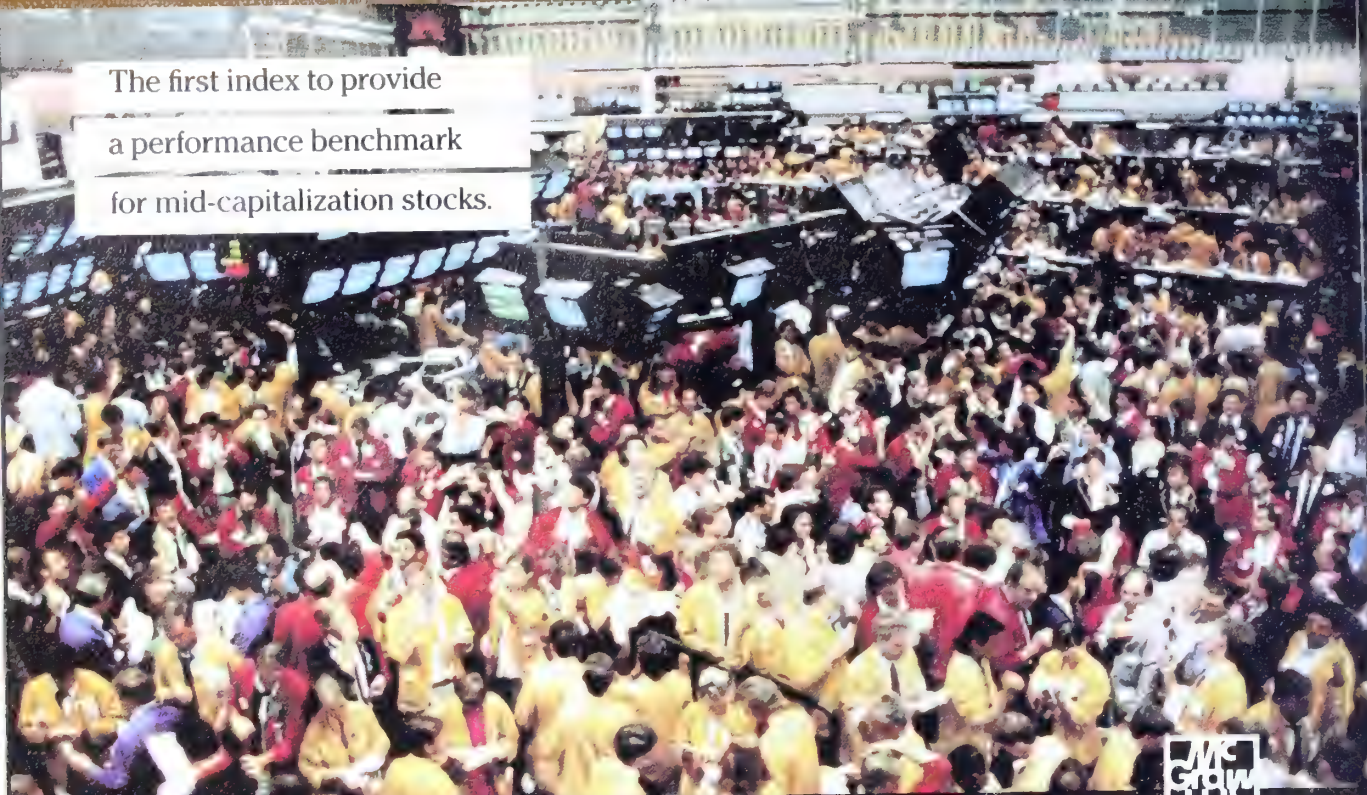
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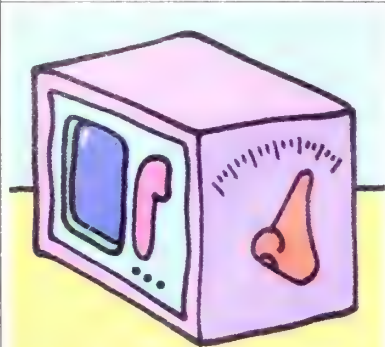
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EDITED BY OTIS PORT

THIS MICROWAVE KNOWS WHEN THE SHEPHERD'S PIE IS DONE



British citizens who are prone to under- or overcooking food in a microwave oven now have a new option: Leave the work to the oven. Sharp Corp. is giving British consumers first crack at a microwave it makes in Wales with a "nose" that knows when the food is done, then shuts itself off.

Actually, the nose doesn't work by smelling the food's aroma. Instead, it sniffs the humidity and temperature in the oven. These readings are fed to a neural network—a type of computer circuitry modeled on the brain—that has been trained to spot the combination of temperature and humidity that signals when different kinds of food are cooked. In Japan, Sharp offers a more advanced model that technohappy Japanese cooks can train to prepare foods to their individual taste. Sharp hasn't yet decided when this capability will be introduced in other markets, and no date has been set for selling the sniffer oven in the U.S.

USING A BACK MUSCLE TO STRENGTHEN WEAK HEARTS

Thousands of people waiting for a heart transplant will die before they get one—there aren't enough donor hearts to go around. But a novel surgical procedure developed by Medtronic Inc. in Minneapolis offers new hope for people with weak hearts. Called cardiomyoplasty, the treatment involves detaching a back muscle without severing its blood vessels and nerves, then threading it into the chest and wrapping it around the heart. Finally, a pacemaker-like device from Medtronic is implanted to stimulate the muscle electrically, causing it to contract and help the heart pump blood.

Not only does this procedure avoid the risk of organ rejection, it costs less than half the \$130,000 bill for a transplant. Some patients leave the hospital after just eight days—although it takes several months for the pacemaker to fully "train" the back muscle. Medtronic says the results can be startling: Some former patients now play tennis. The operation was approved by European authorities in January. In the U.S., the Food & Drug Administration granted permission at the end of August for 20 medical centers to begin testing cardiomyoplasty on 600 patients next year.

THE VIRTUAL CORPORATION GOES 3-D

Virtual-reality tools have helped pilots test new cockpits, architects refine blueprints, and homeowners decorate their kitchens. Soon, the technology could give managers a more vivid grasp of how their companies function. Working with customized hardware and some off-the-shelf virtual-reality (VR) software, two Purdue University professors have built a sys-

tem that lets executives roam through three-dimensional models of their organizations. The system can also create hybrid models of multiple companies to analyze the benefits of a proposed strategic partnership.

Instead of scrutinizing charts and spreadsheets, a group of managers can "walk" together through symbolic domains where colors and shapes depict everything from cash flow to manufacturing operations and staff allocations. "You can be inside a work group, move people around, run a simulation and see the impact on cycle time and product delivery," says Alok Chaturvedi, an associate professor of management and co-developer Chandrajit L. Bajaj, a professor of computer science at the school, are also now tailoring a version for the financial community.

A GENETIC SWITCH THAT TURNS PLANT GROWTH ON OR OFF

Farmers use chemical growth regulators to thin their trees, speed up ripening, and then delay the fruits' fall. Of course, plants have their own ways of doing this—growth hormones. If scientists could figure out how to switch Mother Nature's hormones on and off, environmentally damaging chemicals could take a backseat.

Michigan State University scientists have isolated the first gene controlling the action of a plant growth hormone. The gene regulates the binding of indole-3-acetic acid (IAA), to a sugar molecule. This binding prevents the IAA from promoting growth. Isolating and altering equivalent genes from other crops could produce plants whose fruit follows a tailored growth pattern when triggered by, say, a specific temperature. MSU biochemist Robert S. Bandura estimates that such genetic methods could be available in two years. "As we move toward a greener world, we'd like to control growth genetically rather than chemically," he says.

GI JOE IS GETTING SOME NIFTY NEW DUDS

To give American soldiers the edge in future wars, the Defense Dept. wants a new head-to-toe battle dress. Call it Robo GI.

The soft armor suit will have a backpack computer to enhance hearing and vision, including night vision, and help aim high-tech weapons by showing targeting data on a faceplate screen, called a head-up display. The screen could also display an up-to-the-minute battle map, marking the soldier's position and the enemy's whereabouts. Information will stream in via digital communications from satellites, airborne computers, and local command systems. In turn, the outfit will broadcast a friend-or-foe signal to avoid "friendly fire." And it will be invisible to enemy heat-seeking weapons and night-vision systems, because cooling tubes will line the suit and keep its surface at the same temperature as the outside. To build prototypes by 1999, the Pentagon has awarded a contract worth up to \$44 million to a six-company team led by Motorola Inc.



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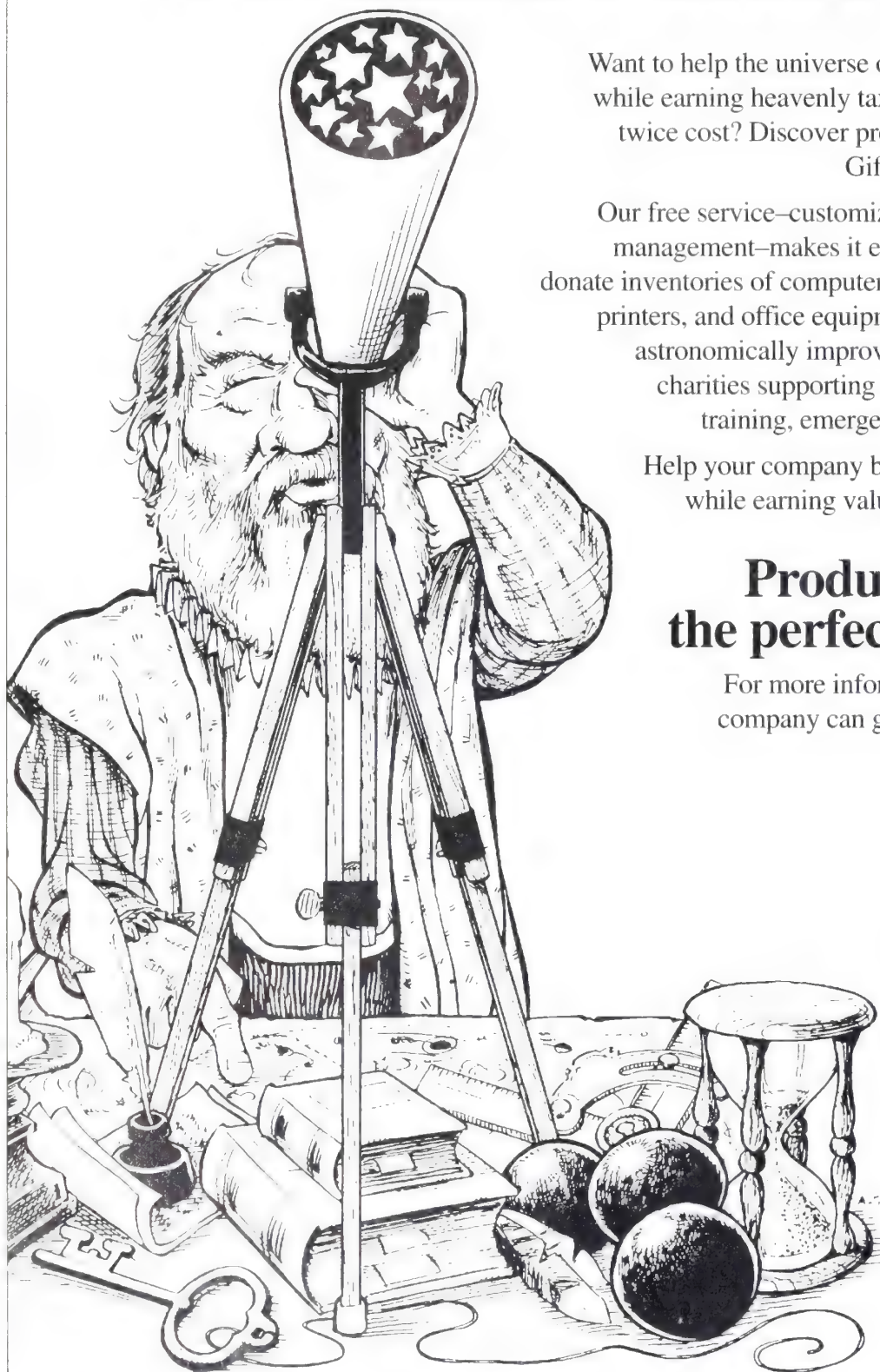
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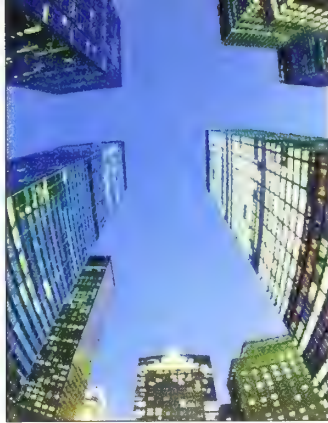
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Galileo Galilei, Astronomer and Physicist, 1564-1642

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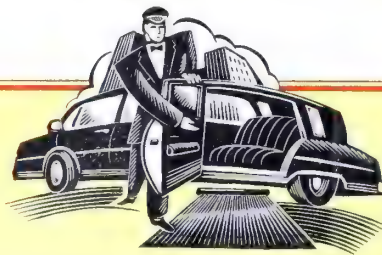
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EDITED BY AMY DUNKIN

Investing

ENERGY STOCKS TO PUMP UP YOUR PORTFOLIO

Is it time, at last, to buy energy stocks? For the past decade, they've been badly depressed, victim to ample supplies that have kept oil sloshing back and forth between \$14 and \$22 a barrel, compared with \$40 to \$50 during its heyday in the early 1980s. But now, as industrialized economies recover and developing nations build advanced infrastructures, some pros see exciting potential in oil and gas issues. "Energy is directly tied to developing countries that are becoming industrialized," says Jeanne Mockard, manager of Boston's Putnam Natural Resources Trust mutual fund. Countries in Asia, the Pacific Rim, and Latin America all need energy to grow, while demand should increase as recoveries continue in Japan, Europe, and the U.S.

BELT-TIGHTENING. For years, bulls have been predicting an energy comeback—without success. The case is still not ironclad. Supplies of crude from Iraq will start flowing again soon, and technology has made finding and pumping new reserves easier than ever. But a number of factors are combining to support the prospect of higher prices. Not surprisingly, it's a story of scarcer supply and growing demand. To cope with tighter budgets, companies have curtailed exploration and drilling, which means a dearth of new energy sources. And it takes about five years to bring new capacity on-line.

In the meantime, many

countries are pulling out of a worldwide recession. Although no one expects energy prices to take off, worldwide demand should rise slowly but steadily at 2% a year for oil and 3% for gas. Oil prices in the U.S. should move from \$17.25 a barrel this year to \$21 in 1996 and gas prices from \$1.82 to \$2.05, says Charles Maxwell, vice-chairman and managing director at C. J. Lawrence.

This could spell a profit gain for the major oil companies of 15% in 1995 and 20% in 1996, Maxwell says. "We think the price of oil, for the first time in 14 years, will be rising faster than inflation, but only modestly." Ernst Von Metzsch, who manages the

top-performing Vanguard Specialized Energy fund, recommends putting 10% to 20% of your assets into such investments. Energy stocks are volatile, but ironically, they can steady your portfolio. That's because they do well when inflation is up, while other securities usually wilt. Utilities, however, stand to suffer from rising energy prices because they rely on oil and gas. And there is often a regulatory lag before they can pass on higher costs to consumers.

"UPWARD COURSE." So where do the pros see the biggest growth in the oil patch? For stability and dividends, albeit with slow-growing profits, look to majors such as Unocal

and Mobil. "They're good value defined by price-to-cash-flow ratios," Maxwell. "They're well-tioned to grow long-term, have strong earnings momentum on an upward course."

Unocal is especially intriguing. With natural-gas geothermal operations in Iceland and Vietnam, it could tap the great demand expected from expanding economies in Southeast Asia. Like most other energy companies, Unocal is still downsizing. With a price-to-cash-flow ratio of 5.3, it's slightly cheaper than most majors, which average 6.0 to 7.0. (Cash flow is commonly used to value



nies because huge
ffs due to depletion of
es can distort earnings.
nings are applicable to
oil-field-service compa-
Unocal's cash flow per
should rise from \$5.40
0 in 1995.

al Dutch/Shell Group
obil are less dramatic
er. Both are extremely
n companies known for
ent, farsighted manage-
"If you want to put
oney away for 10 years
t look at it, buy Royal
" says Scott Black,
ent of investment ad-
Delphi Management in
Royal Dutch is in ev-
or field in the world,
more than 3 million
a day—and has a bal-
sheet bigger than the
national product of
countries. Its stock is
g near the top of its
at 113%. But Von
h thinks it will rise to
xt year.

G EDGE. Mobil is
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finding more oil
Experts say
where oil's future
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so mature. Mobil
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or exploration re-
—have more
potential than the
ted oil-and-gas ma-
After 12 years of
dieting, these com-
are particularly
and mean, says
ll. "They can take
revenue increases
rn them into spec-
gains."

s include industry
s such as Baker
s and Schlumberg-
ch are restructur-
e major suppliers

to the natural-gas industry,
and service oil companies
abroad. They are at the cut-
ting edge of technology:
Three-dimensional seismic
equipment are now better
able to find reserves under
the ocean floor and detect
pockets of oil and gas in wells
thought to be empty. Baker
Hughes could jump from
about 19½ to 26 a share next
year, with earnings up by
35%. Schlumberger's earnings
per share should rise by 50%.

For speculators, volatile off-
shore rig companies could
cough up the biggest rewards.
That's because few new rigs
are coming on line, and several
are destroyed each year by
the sea. As facilities dwindle,
the amount that each rig has
to produce must increase. "If
you use 80% to 82% of capac-
ity, the rigs break even," says
Maxwell. But as production
nears 90%, rigs rake in big
bucks. Maxwell likes Reading
& Bates, Sonat Offshore, En-

Offshore rig outfits might cough up the biggest rewards

ergy Service, and Global Ma-
rine. He expects growth for
these companies to be around
20% in 1995, and 30% to 40%
in 1996.

Vanguard's Von Metzsch is
buying up debt-laden domestic
independent companies that
many analysts think are los-
ers. USX-Marathon, Maxus En-
ergy, and Oryx Energy were
sold off when natural-gas prices
fell off their two-year climb
recently. That makes these
stocks desirable to Von
Metzsch, even though some
are losing money, because he
expects their valuations to
"improve markedly when it's
recognized that oil and gas
prices are trending up."

Marathon has good pros-

pects in the North Sea and
the Gulf of Mexico, he says,
and cash flow per share
should rise 70¢ next year,
while the company's stock
could jump from 18 to 24.
Maxus, meanwhile, is seen as
having weak management,
which has been unable to
make cost-cutting pay off. But
Von Metzsch thinks a strong
bias toward oil production will
help if prices rise. He expects
cash flow per share to rise
50¢ next year, and the stock
to jump from 4½ to 8. Earn-
ings should rise \$2 at Oryx,
and the stock should go from
15 to 25.

RIISING RETURNS. Of the eight
or so natural-resource mutual
funds that focus on oil and
gas, Jay Schabacker, publisher
of *Mutual Fund Investing*, is
recommending Vanguard Special-
ized Energy, Fidelity Select
Energy, and Invesco Strategic
Energy. The energy
funds group, which has trailed
the Standard & Poor's 500-
stock index by almost
four percentage points a
year for the past five
years, is finally beating
it, up 3.93% this year,
compared with a 0.22%
decline for the S&P. The
total return for Van-
guard, which has led the
pack for the past five
years, has risen 7.65%
year to date, vs. 6.57%
for State Street Re-
search Global Energy
funds and 6.44% for Fi-
delity Select Energy.

Fidelity fund manager
Robert Bertelson is seek-
ing companies that can
boost production, such as
British Petroleum, Amer-
rada Hess, and indepen-
dent Canadian Natural
Gas, while Vanguard's
Von Metzsch wants com-
panies other analysts es-
chew. "That's why we're
buying them," he says.
"Most of the people are
usually wrong."

If the energy bulls are
right this time, fuel could
do more than warm your
house and power your
car. It could generate
some cool cash for your
portfolio. *Pam Black*

SOME PICKINGS FROM THE OIL PATCH

Company	Price 9/12/94	Price to cash flow*	Comment
MAJOR COMPANIES			
MOBIL	81½	6.4	Excellent management and good prospects in foreign oil and gas
ROYAL DUTCH PETROLEUM	111½	7.7	Is in every major oil field, has huge output and great managers
UNOCAL	28½	5.3	Well-positioned to serve developing economies in Southeast Asia
INDEPENDENTS			
MAXUS	4½	6.7	Exploration and development company with holdings in Indonesia; burdened with debt
ORYX	15	4.6	In Gulf of Mexico and North Sea; undergoing heavy restructuring
USX-MARATHON	17½	5.0	Integrated company with domestic refining and marketing; heavy debt
SERVICE			
BAKER HUGHES	19	30.16*	Top provider of drill equipment suffering a demand slump abroad
SCHLUMBERGER	56½	25.86*	World leader in drilling, exploration, and measurement services
SONAT OFFSHORE	32½	18.50*	Specializes in deep-water rigs; yields more but costs less than peers

* A price-to-earnings ratio is used to value service companies

DATA: BUSINESS WEEK

Smart Money

WANT SOME THRILLS? TRY FOREIGN BONDS

Playing the global bond market is not for neophytes. But investors who understand the movement of currencies and who keep abreast of political and economic events around the world might want to consider purchasing overseas bonds. Despite the global rise in long-term interest rates, some of them have provided handsome returns this year thanks to the decline in the dollar. And some analysts see further opportunities in the world's battered debt markets. "If you do your homework, you can enhance a portfolio without added risk," says Gary Evans, a senior vice-president at Baring Securities in New York.

That's not so simple, of course. This arena has long been dominated by professionals because it's so difficult to manage currency risk along with the interest-rate and credit risk that go hand in hand with bond investing. Nonetheless, for investors with resources who aren't easily intimidated, getting involved is becoming easier. Many large brokerages and private banks that trade international bonds have minimums of around \$100,000 for retail investors. But several firms are now selling smaller quantities of bonds and have dropped the minimum to as low as \$5,000 in one case.

SQUEEZE PLAY. The main factor to consider is foreign exchange movements. This year, they have worked in favor of U.S. investors as the dollar has fallen against the yen and major European currencies. If you had bought bonds denominated in those currencies, the gains

(13.2% for the yen, 10.7% for the mark, for example) would have more than compensated for the decline in the bonds' price due to rising yields (table).

Granted, this has been an unusual year in the international capital markets. So you wouldn't want to jump into foreign bonds now if you think that the dollar will strengthen. But if you're willing to bet that the dollar will drop further, you might squeeze out some additional currency appreciation. And you will benefit from higher yields. While government bond yields in the U.S. have risen an average of 1.5 percentage points this year, yields shot up 2.2 points in New Zealand and 1.8 points in Switzerland, one reason these bonds are so attractive now, says Edison Lee, an analyst with Friedberg Mercantile Group in Toronto.

Friedberg's U.S. arm in New York (212 943-5300) recently started offering individual investors a choice of 30 foreign bonds, most of which are AAA-rated govern-

ment issues in major currencies such as marks, Swiss francs, or British pounds, with less than five years to maturity. The firm's analysts choose bonds expected to benefit from currency fluctuations and interest-rate declines. The minimum investment is \$5,000, and some bonds can be purchased for under \$1,000. The firm will also manage a global bond portfolio for a minimum of \$80,000.

tional buyers would pay larger quantities of the bonds. Among other things, that sell choice bonds to individuals, Merrill Lynch dropped its minimum for international bond trades from \$50,000 to \$25,000 about a year ago, and it now sells some Canadian bonds in as small as \$10,000.

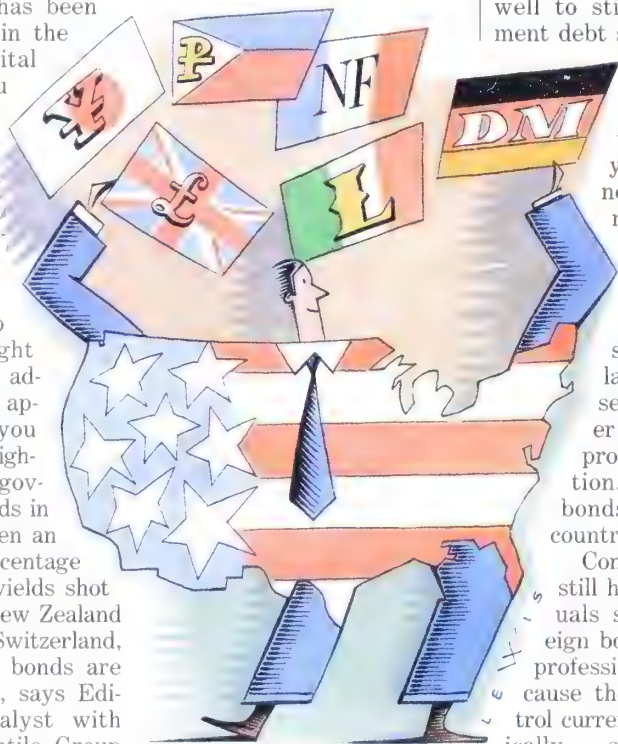
REAL YIELDS. If you're getting started buying foreign bonds, you would well to stick with government debt so you don't

worry about credit risk. In countries with the highest yield," which is nominal yield minus the inflation rate, says Michael Biehler, chief economist and investment strategist for Biehler & Biehler. The bond investor should be able to provide this information. Finally, bonds from several countries.

Conventional wisdom still has it that individuals should leave bond buying to professionals, in part because they hedge to control currency risk. Yet, ironically, such strategy prevented many global mutual funds from benefiting from the dollar's fall, while they all suffered from rising interest rates. Global bond funds are the worst-performing bond-fund category

this year, with a 6.13% decline in average total return through August 19, according to Morningstar Mutual Funds.

Mutual-fund contrarians might see this as an opportunity to buy into the battered international group. And if you really want to hedge against the prevailing view, you can purchase the best yourself. Amey St



Friedberg, like all bond traders, makes its money off the spread between the bid and the asked price. Its spreads—which are close to 1% for less liquid bonds—are sometimes more than institu-

HOW SOME FOREIGN-CURRENCY BONDS PERFORMED

Issue	Currency	Credit rating	Year-to-date return*	Return due to currency	Return due to bond
REPUBLIC OF ARGENTINA 8%, due 5/10/98	Mark	Not rated	13.72%	10.69%	2.73%
GENERAL ELECTRIC 4%, due 2/7/98	Swiss franc	AAA	9.52	12.16	-2.35
WORLD BANK 5%, due 7/8/96	Yen	AAA	11.81	13.19	-1.21
CORPORATE INVESTMENT 13%, due 9/6/95	New Zealand dollar	Not rated	13.88	6.94	6.49

* Through 8/30/94

DATA: FRIEDBERG MERCANTILE GROUP



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Last year alone, we produced enough energy from methane to save 1.9 million barrels of oil. Not only as electricity, but also as an alternative fuel to actually replace gas, oil, or coal for industry. In 1993, we sold it to customers like a carmaker and a chemical company. All of which makes good use of landfill gas.

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Multimedia has become standard fare on desktop personal computers. Besides livening up your work routine, the addition of sound and video can spiff up presentations and aid in training programs. But when it comes to taking your show on the road, "portable multimedia" has so far been something of an oxymoron.

The main problem has been that the relatively hefty CD-ROM drives add too much bulk. As a result, the first full-blown multimedia portables, weighing in at around 20 pounds, are more accurately described as "luggables." Alternatively, some people have resorted to cobbling together systems by plugging in external CD-ROM drives and speakers to their notebook computers. Others drag around a docking station, a device that allows you to connect extra components.

SPARE ROOM. But road warriors can take heart: A new crop of portables with built-in CD-ROM players promises to deliver multimedia on the go without breaking your back. (Of course, at a minimum of \$4,000, the machines might break your bank account.) In September, Panasonic unveiled its V41 notebook, which squeezes a full-size, double-speed CD-ROM, 16-bit stereo sound, and a 10.4-inch screen into a machine just 2.3 inches high. At 8.4 pounds with a floppy drive—9.1 pounds with an extra battery installed—the V41

Computers

MULTIMEDIA: A MOVABLE FEAST

is a few pounds heavier than standard notebooks.

In addition to engineering finesse, Panasonic borrows a trick from IBM's ThinkPads: The V41 tucks the CD-ROM player away under the keyboard, leaving room for a spare CD-ROM disk. The initial

Troy (N.Y.) company was one of the first to offer a notebook with built-in sound and CD-ROM capability. Its high-end model, based on Intel's fastest 486 and equipped with 200 megabytes of internal memory, will cost you more than \$7,000. But Aquiline has

gable, starting later this year. At the same time, advances in technology promise even smaller models to come. Toshiba, a major supplier of CD-ROM drives, is designing a superthin player that's less than an inch high. That will give notebook makers more flexibility in adding multimedia capability.

Any portable multimedia computer worth its salt should have the following: Intel 486 or better microprocessor, at least 8 megabytes of random access memory and hard drive with at least 200 megabytes. An active-matrix screen produces high-resolution images, which is essential if you intend to use video in your presentations.

LIMITED JUICE. These days most multimedia notebooks have a sound chip and speakers built-in, although some require external speakers for stereo sound. Battery power is another factor to consider: Although claims vary, typically you can expect to get about two hours of heavy use before a recharge, so make sure that your portable comes with power management software. Other items on your checklist: expansion slots for adding external speakers or monitors and a comfortable, not cramped keyboard. (Southpaws might want to opt for a keyboard with a pointer or trackball placed in the center, rather than a mouse mounted on the right-hand side.)

If you're still having a hard time justifying the hefty price tag, think of it this way: A computer maker packs the full power of a desktop into notebook-size models, a multimedia portable might soon be the only machine you'll need.

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PORTABLE PLEASURES

IBM THINKPAD 755C ▶ Lightweight notebook, but the multimedia's in the companion docking station. Next month: New ThinkPads with fully integrated multimedia. **Price: \$6,000-\$9,000** for a multimedia system.

▶ **PANASONIC V41** Hides a full-size CD-ROM under a flip-up keyboard. At 9.1 pounds and battery-powered, it's one of the first true portables. **Price: \$4,299 to \$7,799.**

AQUILINE HURRICANE At 10 pounds with a built-in CD-ROM, a lightweight choice. **Price: \$4,190 to \$7,390.**

DOLCH PAC 586-60 20-pound Pentium-powered desktop-in-a-box. **Price: \$7,000 to \$9,000.**

TEXAS INSTRUMENTS TRAVELMATE 4000M SERIES Comes with built-in sound but requires an \$849 portable docking station for CD-ROM and stereo quality. **Price: \$2,999 to \$5,299.**

TOSHIBA T6600C/CD ▶ Packs a virtual desktop into an 18-pound "luggable." **Price: \$8,299.**

DATA: BUSINESS WEEK

V41 models run on Intel's 486 processors, and they can be equipped with varying amounts of hard-disk capacity and internal memory. A model based on Intel's speedy Pentium chip is due out late this year.

Another good bet is the Hurricane from Aquiline. The

models starting at \$4,190. All of the Hurricane computers include a chip that makes them compatible with the Sound Blaster audio standard, as well as a mike and headphone jacks.

ALL-IN-ONES. That's just the beginning. IBM is readying a new line of all-in-one ThinkPads that do away with the need for a docking station. Big Blue won't reveal much about the new machines, due in October, but execs say the company is working on units with built-in CD-ROMs, advanced telephone capabilities, and energy efficiency. And keep an eye out for new multimedia portables from Toshiba, Apple, and Dolch, which makes a high-end lug-

Worth Noting

■ **BOND BASICS.** Investors trying to cope with the bond market can consult *Discovering Opportunities with Fixed Income Investments*, a free guide from Fidelity Investments. The booklet describes various fixed-income plays and touches on basic strategies. Call 800 544-8888.

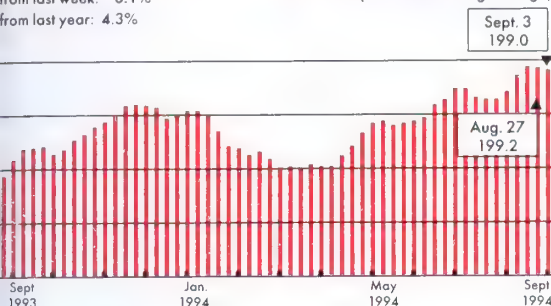
■ **TRAVEL DISCOUNTS.** Visa credit-card holders who use their plastic at Marriott hotels, on Carnival cruises, and for other travel services can earn credits worth 20% of the charges. The credits can be applied to future vacations with those participants. The promotion, which runs from Oct. 1 to Dec. 31, will also grant 10% credits for general Visa usage.

Business Week Index

PRODUCTION

Change from last week: -0.1%
Change from last year: 4.3%

1967=100 (four-week moving average)

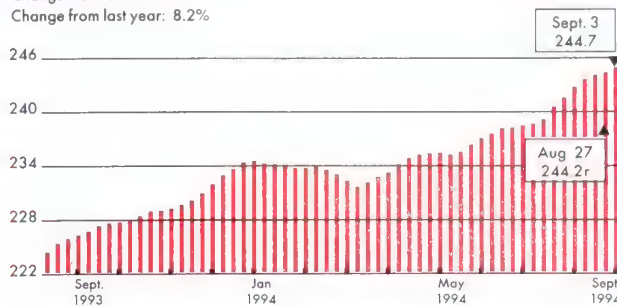


Production index declined slightly during the week ended Sept. 3. On a seasonally adjusted basis, output levels of electric power, crude-oil refining, paper, and cardboard all dropped. Auto, steel, and truck production rose, while coal and rail-freight traffic were unchanged. Before calculation of the four-week moving average, the index dropped to 198 from 198.7. For August, the index rose to 198.5, from 196.3.

BW production index copyright 1994 by McGraw-Hill Inc

LEADING

Change from last week: 0.2%
Change from last year: 8.2%



The leading index edged higher during the week ended Sept. 3, as a rally in the financial markets pushed up stock prices and lowered bond yields. Also, the growth rates for materials prices and real estate loans rose. M2 growth fell, and data for business failures were unavailable. Before calculation of the four-week moving average, the index rose to 246.1, from 244.4. The index increased to 244.5 in August, from July's 241.3.

Leading index copyright 1994 by Center for International Business Cycle Research

PRODUCTION INDICATORS

	Latest week	Week ago	% Change year ago
Auto (9/10) thous. of net tons	1,781	1,894#	-3.2
Auto (9/10) units	110,952	127,786r#	29.1
Auto (9/10) units	100,890	115,578r#	24.5
ELECTRIC POWER (9/10) millions of kilowatt-hours	59,863	64,790#	0.6
CRUDE OIL REFINING (9/10) thous. of bbl./day	14,403	14,259#	4.2
Auto (9/3) thous. of net tons	20,949#	21,010	10.4
BOARD (9/3) thous. of tons	905.4#	903.6r	11.9
Auto (9/3) thous. of tons	823.0#	828.0r	-1.2
Auto (9/3) millions of ft.	474.1#	477.2	6.8
TRUCK TRAILER (9/3) billions of ton-miles	24.7#	24.6	10.3

#American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, Petroleum Institute, Energy Dept., American Paper Institute, WWPAA, SPPA, Association of American Railroads

FOREIGN EXCHANGE

	Latest week	Week ago	Year ago
YEN (9/14)	99	99	104
MARK (9/14)	1.54	1.55	1.61
POUND (9/14)	1.57	1.55	1.53
FRANC (9/14)	5.27	5.31	5.63
GERMAN DOLLAR (9/14)	1.35	1.37	1.31
FRANC (9/14)	1.28	1.30	1.41
ARGENTINE PESO (9/14) ²	3.411	3.398	3.106

¹Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound expressed in dollars

COMMODITIES

	Latest week	Week ago	% Change year ago
Gold (9/14) \$/troy oz.	390.300	389.700	12.2
CRAP (9/13) #1 heavy, \$/ton	134.50	134.50	19.6
OFFS (9/13) index, 1967=100	215.3	213.7	1.4
(9/10) c/lb.	121.3	119.1	34.1
UM (9/10) c/lb.	75.8	74.0	41.6
(9/10) #2 hard, \$/bu.	3.99	3.90	19.5
(9/10) strict low middling 1-1/16 in., c/lb.	72.54	71.29	35.5

¹London Wednesday final setting, Chicago market, Knight-Ridder Commodity Research Metals Week, Kansas City market, Memphis market

Data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment from Wood Products Assn. ²Southern Forest Products Assn. ³Free market value NA=Not available r=revised NM=Not meaningful

LEADING INDICATORS

	Latest week	Week ago	% Change year ago
STOCK PRICES (9/9) S&P 500	471.74	474.06	2.9
CORPORATE BOND YIELD, Aaa (9/9)	8.22%	8.09%	26.3
INDUSTRIAL MATERIALS PRICES (9/9)	107.1	106.9	12.9
BUSINESS FAILURES (9/2)	NA	326	NA
REAL ESTATE LOANS (8/31) billions	\$438.2	\$436.0	5.7
MONEY SUPPLY, M2 (8/29) billions	\$3,562.5	\$3,564.3r	2.3
INITIAL CLAIMS, UNEMPLOYMENT (8/27) thous.	333	323	2.1

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of large companies), Federal Reserve, Labor Dept. CIBCR seasonally adjusts data on business failures and real estate loans

MONTHLY ECONOMIC INDICATORS

	Latest month	Month ago	% Change year ago
BUSINESS WEEK PRODUCTION INDEX (August)	198.5	196.3r	5.4
BUSINESS WEEK LEADING INDEX (August)	244.5	241.3r	8.2
CONSUMER PRICE INDEX (August)	149.1	148.6	2.9
PRODUCER PRICE INDEX (August) finished goods	126.6	125.8	1.9

Sources: BW, CIBCR, BLS

MONETARY INDICATORS

	Latest week	Week ago	% Change year ago
MONEY SUPPLY, M1 (8/29)	\$1,154.5	\$1,154.4r	5.3
BANKS' BUSINESS LOANS (8/31)	300.3	299.5r	9.7
FREE RESERVES (8/31)	511r	501r	-37.4
NONFINANCIAL COMMERCIAL PAPER (8/31)	149.4	148.3	-5.4

Sources: Federal Reserve (in billions, except for free reserves, which are expressed for a two-week period in millions)

MONEY MARKET RATES

	Latest week	Week ago	Year ago
FEDERAL FUNDS (9/13)	4.64%	4.81%	3.03%
PRIME (9/14)	7.75	7.75	6.00
COMMERCIAL PAPER 3-MONTH (9/13)	4.95	4.91	3.15
CERTIFICATES OF DEPOSIT 3-MONTH (9/13)	4.95	4.87	3.12
EURODOLLAR 3-MONTH (9/9)	4.89	4.88	3.06

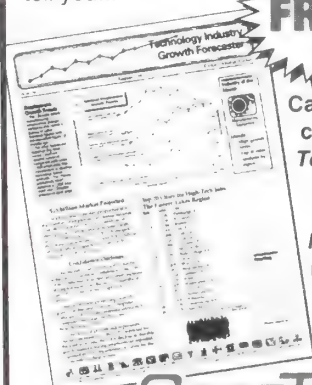
Sources: Federal Reserve, First Boston

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birthday,
another laugh,
another hug,
another
chance.



American Red Cross

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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

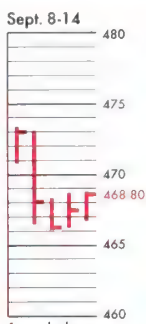
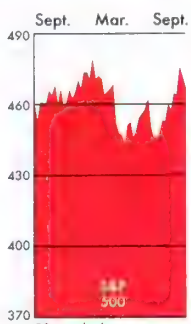
A	D	J	P
Acer 64	D.A. Campbell 112	J.C. Penney 12	Pumam Natural Resources Trust 146
Adobe Systems 114	Dana 60	Jones Interco 132	R
Advanced Micro Devices 64	Dataquest 78	J.P. Morgan 81, 106	Rank Xerox 118
Affymax 84	Dean Foods 55		RCA 68
AirTouch 68	Dean Witter 68		Reading & Bates 14
Aldus 114	Dell 64, 68		Recombinant Capital 14
Allstate Insurance 110	Delphi Management 146		Regeneron 84
Amerada Hess 146	Deutsche Bank 118		Rhône-Poulenc Rorer 14
American Cyanamid 84	Deutsche Telekom 76, 121		RJR Nabisco 55
American Express 6, 66, 135	Dolch 150		Roche Holdings 84, 92
American Rice 112	DRJ/McGraw-Hill 62		Rostelekom 76
Amerindo 84, 92	Duke Power 106		Royal Dutch/Shell 1
Ameritech 118	E		S
Amgen 84, 88	Eastman Kodak 8		Safeway Stores 55
Apple Computer 64, 100, 150	Energy Service 146		St. Paul Cos. 81
Aquiline 150	Equifax 81		Salomon Brothers 5
ARC International 106	Equitable Life Insurance 114		Samsung 129
AT&T 8, 68, 118, 119, 120, 124	Eryl Industries 112		Sandoz Pharma 92
A.T. Kearney & Associates 55	Ernst & Young 84		Schering-Plough 92
Atlanta Gas Light 81	F		Schlumberger 146
B	Fadal Engineering 60		Sealand Services 11
Baird, Biehl & Kaiser 148	Farmers Insurance 110		Seiko Epson 17
Bain 100	Farrallon Computing 114		Sharp 129, 144
Baker Hughes 146	Fidelity Investments 84, 88, 146, 150		Silicon Graphics 12
Baltimore Orioles 135	First Tennessee Bank 100		Singapore Telecom 119
Baring Securities 118, 129, 148	Fox Broadcasting 73		Somatix Therapy 92
Baron Capital Management 112	Frame 114		Sonata Offshore 146
Bell Atlantic 68, 118	France Telecom 76, 118, 121		Sotbeby's 6
Bell Canada 132	Friedberg Mercantile Group 148		South Shore Bank 8
Biogen 84, 88	Fujitsu 64		Spears, Benzak, Salo 100
Biotechnology Select Fund 84	G		Farrell 84
Borden 55	Gartner Group 114		Spicer Axle 60
Bristol-Myers Squibb 84	GE 66, 68, 129		Sportif 118
British Petroleum 146	Genentech 84, 88, 92, 154		Sprint 68, 81, 118, 120
British Telecom 118, 120, 124	General Mills 81		State Farm Insurance 11
Bruno's 112	Genetics Institute 84		Stentor 120
Burrill & Craves 84	Genetic Therapy 92		Steptoe & Johnson 2
C	GenVec 92		Stop & Shop 55
Cable & Wireless 118, 124	Global Marine 146		Synergen 84
Canadian Natural Gas 146	GM 6		Systemix 84
Canandaigua Wine 106	Goldman Sachs 54		T
Canon 17	Goldstar 129		Tele Danmark 118
Capital Research 84	Grand Metropolitan 106		Tele-Communications 132
Carlson Travel Network 66	GTE 118		Telecom New Zealand 1
CellPro 84	H		Telefónica de España 1
Centocor 84	Hambrecht & Quist 88		TeleGeography 118
Cephalon 84	H&R Block 100		Telekom Malaysia 1
Chase Manhattan 106	Hanson 55		Telefonos de México 1
Checkfree 100	Heinz (H.J.) 55		Telstra OTC Australia 119
Chevron 66	Hewlett-Packard 17, 78		Textron 81
Chevy Chase Federal Savings Bank 52	Holiday Inn 66		Thomas Cook Travel 6
China United Telecom 118	Honeywell 52		Toshiba 64, 150
ChipSoft 100	Hong Kong Telecom 119		Trumpf 60
Chiron 84, 88	Houston Lighting & Power 106		U
Choice Hotels International 112	Huntington Bancshares 81		Unisource 119
Cincinnati Milacron 60	I		United Artists 124
Citibank 106, 135	IBM 6, 68, 78, 150		United Services Automobile 81
C.J. Lawrence 146	ICI 118		Unocal 146
Coca-Cola 6, 81	Imax 68		US West 68, 76
Compaq 64, 78	Immune Response 84		USX-Marathon 146
Computer Intelligence InfoCorp 114	Immunex 84		V
Computer Sciences 78	Intel 64, 150		Vanguard Specialized Energy Fund 146
Cor Therapeutics 84	Interleaf 114		Viagen 92
Cortech 84	Inhuit 100		Vical 92
CS First Boston 73	Invesco Strategic Energy Fund 146		Videotron 124
CV Therapeutics 84			Visa 6, 100, 150
			Vobis Microcomputer 1
			W
			Wachovia Bank 135
			Walt Disney 68
			Wendy's 6
			WMX Technologies 1
			Wordperfect 114
			X
			Xoma 84
			Z
			Zenith Electronics 12

Investment Figures of the Week

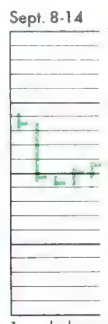
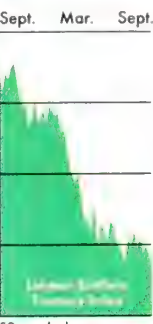
STOCKS

Unusually high producer prices raised inflation fears in Sept. 9, the bond market moved through one of its peaks this year. Not even a modest consumer price increase reported on Sept. 13, could do much damage. For the week, rates rose across the board. Given the turmoil in bonds, the S&P 500 finished slightly higher; the S&P 500, slightly in the red, and OTC issues all gains as well.

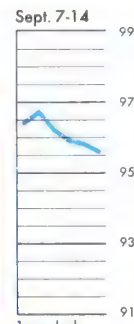
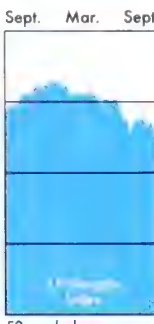
STOCKS



BONDS



THE DOLLAR



MARKET ANALYSIS

	Latest	% change Week	% change 52-week
INDUSTRIALS			
INDUSTRIALS (S&P MidCap Index)	3895.3	0.2	7.2
INDUSTRIALS (Russell 2000)	176.1	-0.6	2.7
INDUSTRIALS (Russell 3000)	257.6	0.3	5.0
INDUSTRIALS (Russell 3000)	269.7	-0.4	1.3
FINANCIALS			
FINANCIALS (FINANCIAL TIMES 100)	3079.8	-3.9	3.0
FINANCIALS (NIKKEI INDEX)	19,919.4	-0.5	-4.9
FINANCIALS (TSE COMPOSITE)	4345.0	0.1	9.5

FUNDAMENTALS

	Latest	Week ago	Year ago
90-DAY TREASURY BILL YIELD	4.68%	4.65%	3.03%
30-YEAR TREASURY BOND YIELD	7.67%	7.56%	5.98%
S&P 500 DIVIDEND YIELD	2.71%	2.70%	2.72%
S&P 500 PRICE/EARNINGS RATIO	18.6	18.7	23.9

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 26-week moving average	460.9	460.7	Positive
Stocks above 26-week moving average	42.0%	44.0%	Neutral
Speculative sentiment: Put/call ratio	0.39	0.40	Neutral
Insider sentiment: Vickers sell/buy ratio	1.07	0.98	Positive

BLOOMBERG FINANCIAL MARKETS, BRIDGE INFORMATION SYSTEMS INC.

INDUSTRY GROUPS

MONTH LEADERS	% change		Strongest stock in group	% change		Price
	1-month	12-month		1-month	12-month	
MINING	14.1	24.3	PLACER DOME	17.5	30.6	23 1/2
FACTURED HOUSING	13.6	18.1	SKYLINE	14.9	22.3	21 1/4
COMMUNICATIONS EQUIPMENT	13.2	8.2	DSC COMMUNICATIONS	27.9	-2.8	29 57/64
DOCUMENTATION	10.4	27.9	TEKTRONIX	13.8	45.8	35
TOOLING	9.6	-11.1	GIDDINGS & LEWIS	13.2	-12.4	20 3/8
MONTH LAGGARDS	% change		Weakest stock in group	% change		Price
	1-month	12-month		1-month	12-month	
INDUSTRIAL COMPANIES	-6.8	-30.6	NIAGARA MOHAWK POWER	-23.9	-50.5	12 3/8
TELEPHONE COMPANIES	-6.3	-13.5	BELLSOUTH	-10.2	-8.5	56 3/8
INSURERS	-5.6	-21.0	SOUTHWEST AIRLINES	-12.9	-29.0	23 5/8
FINANCE BROKERS	-4.8	-11.3	MARSH & McLENNAN	-5.7	-11.5	80 7/8
PROPERTY-CASUALTY INSURERS	-3.9	-20.0	CONTINENTAL	-23.0	-53.4	14 5/8

MUTUAL FUNDS

	%	LAGGARDS	%
4-week total return		Four-week total return	
WATSON STRATEGIC INVESTMENTS	17.0	SMITH BARNEY SHEARSON TELECOMM. INCOME	-4.6
WATSON SERVICES GOLD	16.5	DREYFUS EDISON ELECTRIC INDEX	-4.3
WATSON PRECIOUS METALS	14.2	COLONIAL UTILITIES A	-4.0
52-week total return		52-week total return	
WATSON STRATEGIC INVESTMENTS	95.1	MONITREND GOLD	-34.7
WATSON SERVICES GOLD	57.0	STEADMAN OCEANOGRAPHIC TECHNOLOGY	-28.2
WATSON EMERGING MARKETS INSTL.	50.5	AMERICAN HERITAGE	-25.6



MORNINGSTAR INC.

RELATIVE PORTFOLIOS

Amounts as of the present of \$10,000 one year ago portfolio	Foreign stocks	Gold	U.S. stocks	Money market fund	Treasury bonds
Pages indicate total returns	\$12,027 -1.32%	\$11,045 +0.52%	\$10,453 -0.92%	\$10,204 +0.05%	\$8,968 -1.68%

DRI/McGRAW-HILL

On this page are as of market close Wednesday, Sept. 14, 1994, unless otherwise indicated. Groups include S&P 500 companies only; performance and share prices are as of market close.

Sept. 13. Mutual fund returns are as of Sept. 9. Relative portfolios are valued as of Sept. 13. A more detailed explanation of this page is available on request. r = revised

A RUDE, BUT NEEDED, AWAKENING FOR BIOTECH

Markets giveth. Markets taketh away. So goes the shakeout in biotechnology. But while it's easy to mope about what went wrong—"avaricious" venture capitalists, naive entrepreneurs, ill-advised testing shortcuts—the reality is that the impending consolidation is the best strategy for the long-term health of this still-promising industry.

For too long, biotech has lived in a financial dream world, with stocks trading on little more than "a perception of an expectation." With over 1,000 companies in the field, many of them one-product concerns, technology and capital have become stretched extremely thin. Instead of generating a stream of new biotech products, the industry has produced more failures than successes.

Hence the winnowing. Only a quarter of the existing biotech bunch are expected to survive. But new technologies won't be lost. They'll come to rest in companies with the resources to develop them—larger biotech players and the pharmaceutical giants. Although drug biggies are notorious for being bureaucratic, they must now find a way to nourish the entrepreneurial sparks propelling biotechnology. Alliances such as the one between Roche Holdings and Genentech have shown it can be done.

The second stage in the biotech revolution is about to begin. The markets placed bets, spreading capital widely to increase the odds of success. Now the markets are separating the winners from the losers. The markets worketh.

GIVE RUSSIA TRADE ADVICE, NOT HANDOUTS

The upcoming Yeltsin-Clinton summit provides an opportunity to demolish one of the great policy myths bandied about in Washington circles. That is, the routing of reformers in the last Russian election would result in hyperinflation, economic chaos, and political instability. It simply didn't happen.

Thanks to Prime Minister Viktor Chernomyrdin, inflation is down to 5% a month from 30% a year ago, the ruble is steady, and industrial production appears to be bottoming out. In fact, official statistics are probably missing an upturn in the economy where much activity remains off the books.

So stable is the economy that American and European securities houses are investing up to \$500 million a month in the stocks of newly privatized companies, from aluminum to telecommunications. Joining the investment flow is a portion of the \$40 billion in flight capital that left the country because of inflation and taxes. In a world of international capital markets, portfolio investment can finance true economic growth for the first time in years.

This is where the U.S. can help. Russia lacks a single

stock quote system and clearing house. Most trading goes directly between individuals and brokers all over the country. As a recent stock scandal indicates, it is prone to corruption.

The U.S. is already supporting the creation of a NASDAQ-style stock market in Moscow. It should expand the project to tie in every major Russian city. It can help further by helping to write basic legal and regulatory protections needed for a legitimate capital market.

Investment and trade, not foreign aid, are the way to help Russia to make the transition to a growing, market economy. The U.S. can help further by increasing Overseas Private Investment Corp. resources for American companies doing business there and by increasing Russia's access to U.S. markets. Moscow could even use some help from Madison Avenue. The Sharper Image catalog is already offering Russian binoculars. How about: From our spies to your eyes.

THROW THE BASEBALL EXEMPTION OUT

In a world of deregulation and market competition, where even Russia and China recognize the fruits of free enterprise, it is quite amazing that America's pastime is exempt from the rules of supply and demand. Major League Baseball's antitrust immunity harks back to 1922 when the U.S. Supreme Court ruled that baseball was not a business and therefore did not fall under federal antitrust laws. A ruling in 1953 left the door open for Congress to remove the exemption. If the antics of this year's boobs of sports count for anything, it is that the time has come for the Washington senators—and representatives—to act. Remove baseball's antitrust exemption now.

Baseball's cartel status severely twists the nature of the game. It has emboldened the owners to pick a fight with the players' union in an attempt to artificially cap their salaries and use the resulting funds to subsidize weak franchises that the market won't support.

Without the exemption, the players could have asked the courts to rule on whether the proposed salary cap is an unfair labor practice. Instead, the players' union subjected baseball fans to a strike just as the season was heating up. Now there will be no Matt Williams chasing Roger Maris home run tally. No Cleveland Indians in the playoffs. No World Series. Amazing.

With million-dollar salaries and billion-dollar television deals, the idea that baseball is not a business is simply ludicrous. In the end, baseball is a business no different than football, basketball, and hockey, none of which is exempt from antitrust regs.

In a free market, owners would have to run their franchises as businesses, not ego-satisfying toys. Mediocre players would have to stop whining about their seven-digit salaries. And fans would have to watch teams move from Montreal to Pittsburgh to Phoenix or Tampa/St. Pete. With the 1994 season called on account of greed, the message is clear: Yank the antitrust exemption and let baseball get back to business—entertaining the fans.

The Automotive Equivalent of a Bull Market.

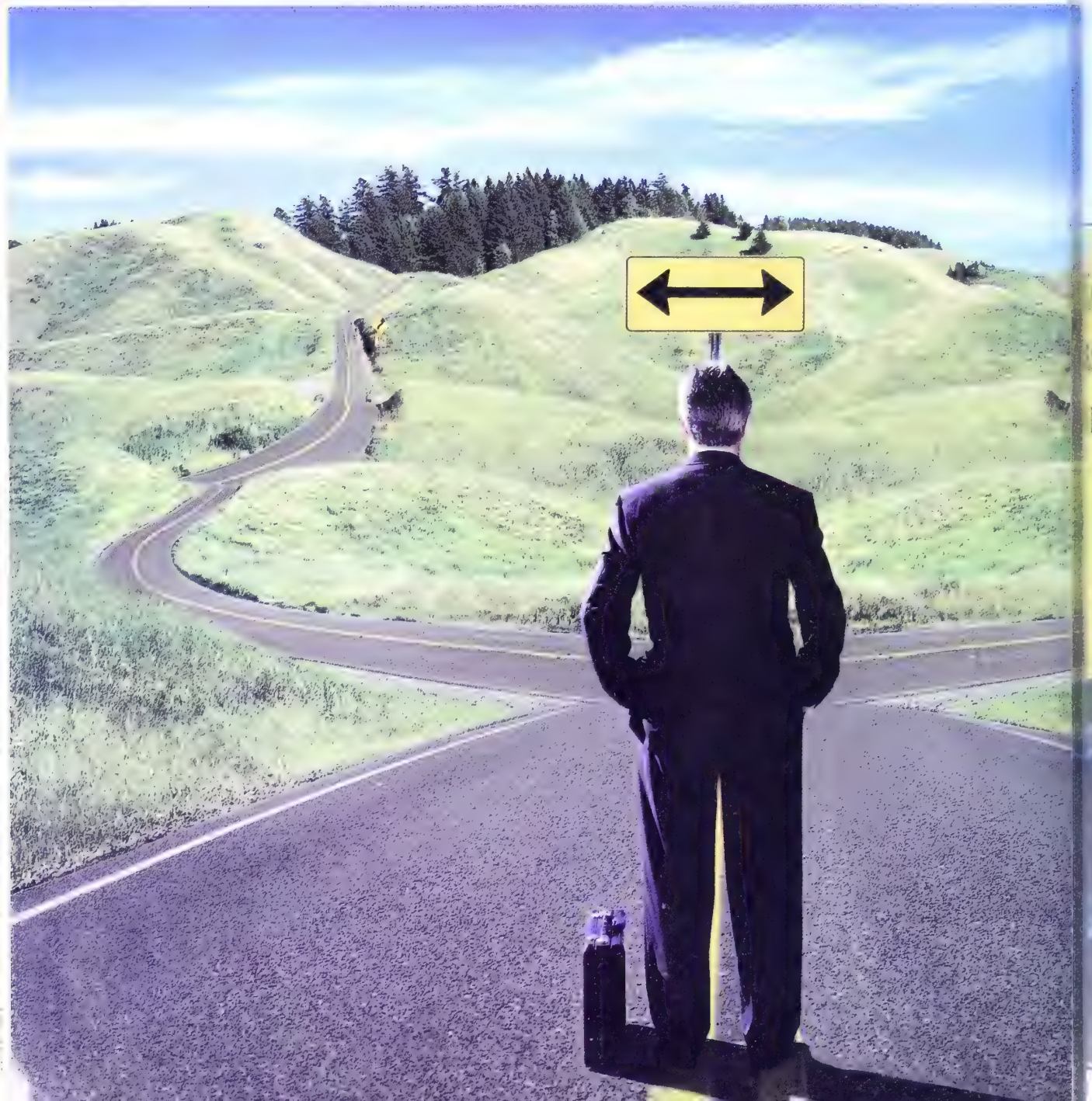


go 100,000 miles before its first tune-up. It has a 32 valve, DOHC V8 that broke 47 different speed-endurance records during development. Ninety percent peak torque is available between 1,700 and 5,600 RPM. And with 250 horsepower, it might be just the boost that the market is looking for. The new

ra luxury-performance sedan by Oldsmobile. See what happens when you Demand Better. 1-800-718-7778.

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PAGE 88



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We can all take a lesson from the Trojans. No matter how something appears on the outside, it pays to look under its skin.

Suppose your business is wholly domestic. Like one of our forest products client's is. Their business is all done in their home country's currency. No need for them to worry about the ups and downs of foreign exchange.

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Risk wears many disguises. Helping you see beneath its surface is the strength of Bankers Trust.



"THE GOOD NEWS IS OUR MOMENTUM IS BUILDING," SAYS APPLE PRESIDENT BUCKLEY. THE BAD NEWS: MOST BUSINESS USERS DON'T CARE

Cover Story

88 SPINDLER'S APPLE

Pragmatic and hard-charging, Apple's new CEO couldn't be more different from the company's founders. Known as the Diesel, he's been slashing costs, launching new Macs, and crafting a more businesslike Apple. He's gotten results, but in the long term, can he keep the company from becoming a marginal—and thus, endangered—player in the PC game?

94 CORPORATE FLOP

Was Apple meant to wear a suit?

Top of the News

50 MENDING HAITI

It's going to take a lot of aid and investment, but the economy can be salvaged

52 COMMENTARY

In Haiti as elsewhere, Clinton's foreign policy method is maddening

53 COMMENTARY

The time has come for Washington to get tough with the Japanese. Really

54 COKE ON THE RAMPAGE

After years of stagnant market share, the cola king is determined to rev up its fortunes

56 RUPERT'S SHOT AT THE END ZONE

Baseball's collapse is making Fox's football coup look even sweeter, as ratings and ad revenues soar

57 CAN THE UAW CLAW CAT?

The union went on strike three months ago, but it has yet to stop production or profits

58 HAUNTED WESTINGHOUSE

A suit by Duquesne Light could leave its balance sheet in tatters

60 WHEN LESS IS MORE

A medical study finds many procedures unnecessary or harmful

62 IN BUSINESS THIS WEEK

Oracle software, aluminum, bank layoffs, inner-city shopping, Lotus, Kmart's CEO, food-chain merger

International Business

66 BRAZIL

With the economy looking healthier, the nation may be poised to become the next Latin American dynamo

68 HONG KONG

A spat over Jardines raises worry about the colony's future

73 INTERNATIONAL OUTLOOK

Do France's Socialists have a prayer of hanging on to the Elysée?

Economic Analysis

22 ECONOMIC VIEWPOINT

Roberts: Bullying banks?

26 ECONOMIC TRENDS

New U.S. plants, Irish boom, energy imports, California's recovery

47 BUSINESS OUTLOOK

Full-tilt factories: Don't be alarmed

Government

65 WASHINGTON OUTLOOK

Marion Barry may be more than just an embarrassment for Dems



4 "IT'S A WORLDWIDE UPSWING":
LEGENDARY INVESTOR GEORGE
SOROS AND HIS CHIEF TRADER,
STANLEY DRUCKENMILLER, ASSESS
THE GLOBAL FINANCIAL FUTURE

50 AN ECONOMY IN FLAMES:
HAITI COULDN'T GET MUCH POORER,
BUT STABILITY AND AN OPEN
ECONOMY COULD WELL GET IT ON A
FOOTING WITH REGIONAL RIVALS

76 THAT BURNING SENSATION AT GLAXO:
FACING SLOW GROWTH, RICHARD
SYKES, INCOMING CHAIRMAN AT THE
WORLD'S NO. 2 DRUGMAKER, MUST
FIND PARTNERS—AND NEW DRUGS

BANK ALARMS

From undercover agents to a
crackdown on lending bias, the
Clintonites step up industry scrutiny

A HOT SEAT FOR MR. MCCOLL

NationsBank's CEO faces hearings

The Corporation

GLAXO WON'T GO IT ALONE

The drugmaker is seeking a
strategic alliance to shore up sales

LISTENING TO PROZAC...

And other drugs that may aid Glaxo

Marketing

DILLARD'S HEADACHE

Its everyday low-price policy isn't
luring enough customers

Media

CHRIS-CRAFT'S NEW NETWORK

Its TV venture with Paramount is
facing a tough launch

Special Report

A GLOBAL BATTLE FOR CAPITAL

Is there enough cash to feed the
worldwide recovery? Innovative
financing may make the difference

A TALK WITH GEORGE SOROS

"For once, we're all in sync.
The recovery...is there"

COMMENTARY

The IMF should be looking forward,
not back

Finance

110 "SOFT DOLLARS"

The Street loves them—but
investors may be getting soaked

112 A FUTURES FUND THAT GOT AWAY

Lake States: An elaborate fraud?

114 CALPERS' QUIET FIREBRAND

Its new chief will keep the heat on

116 INSIDE WALL STREET

Small-cap plums ripe for picking
Waiting for a go-ahead CEO
Where S-K-I is getting its lift

141 INVESTMENT FIGURES OF THE WEEK



86 DIGGING A CHANNEL:
EVEN WITH SEASONED TV EXEC LUCIE
SALHANY AND A STAR TREK SPIN-OFF,
CHRIS-CRAFT'S PROPOSED FIFTH
NETWORK IS A RISKY PROPOSITION

Science & Technology

117 DIGITAL HOSPITAL

Health reform and high tech have
made telemedicine viable at last

121 DEVELOPMENTS TO WATCH

Fingerprinting pollutants, bone
phone, nontoxic phosphors, DNA
sequencing, new glass fiber

Environment

128 COMMENTARY

We can fight smog without
breaking the bank

Personal Business

130 SOFTWARE: PC novices, take heart

MUTUAL FUNDS: 800 numbers

HEALTH: Acne's late-blooming cousin

SMART MONEY: Ransom insurance

Features

6 UP FRONT

12 READERS REPORT

18 BOOKS

Nocera: *A Piece of the Action*

20 TECHNOLOGY AND YOU

Scanners scaled down to the desktop

139 BUSINESS WEEK INDEX

140 INDEX TO COMPANIES

142 EDITORIALS

Haiti needs economic democracy

New minds for U.S. foreign policy

Markets that welcome capital get it

Up Front

TALK SHOW

Haiti has to focus on the 20th century, while the rest of the world is focused on the 21st century.

—Lionel Delatour, Haitian businessman and member of the Center for Free Enterprise & Democracy, which opposes military rule

EDITED BY LARRY LIGHT AND JULIE TILSNER

EAVESDROPPERS

SPEAK SOFTLY AND CARRY A BIG SCRAMBLER

As Jimmy Carter's peace mission flew back to Washington on Sept. 18, it encountered last-minute anxiety that Haiti's military might balk at the deal he had just negotiated. Fortunately, that didn't end up happening, as

sin, a National Security Council staffer, that President Bill Clinton had sounded too hard-line in earlier televised remarks hailing the breakthrough, causing "problems" in Haiti. Rossin said he and General Colin Powell, another delegation member, "had the same reaction—that we should soften it up."

In the second call, Pastor woke up Carter with the news that edgy Haitian generals wanted the U.S. troop contingent scaled back. Pastor, who had gotten this from the Haitian Foreign Minister because he couldn't reach the generals, suggested that the invasion be delayed as a goodwill gesture. Carter replied: "If the Haitian military is not available, I can't stop what we are going to do."

Later, when shown a transcript of the intercepted calls during a CNN interview, Carter said he was "taken aback." He added: "Now I see what happened to Prince Charles," who two years ago was overheard on an intimate phone call. Otherwise, Carter and Pastor weren't available for comment. *Mark Lewyn*



PEACEMONGERS: Carter & Co.

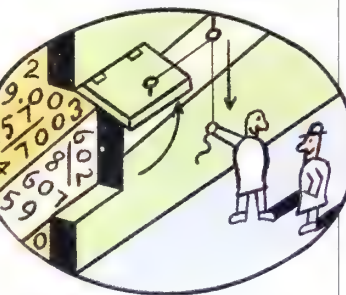
U.S. troops landed unopposed the next day. The behind-the-scenes glimpse comes from a tape obtained by BUSINESS WEEK of two calls over an unsecured radio link from Carter aide Robert Pastor in Port-au-Prince to the plane.

In the first call, Pastor complained to Lawrence Ros-

NUMBERS GAME

ACCOUNTANTS WANT MORE ACCOUNTABILITY

Accountants, who have been zapped by megabuck judgments after S&Ls and other healthy-seeming clients collapsed, are pushing to make financial statements disclose more info. To the dismay of Corporate America, a blue-ribbon committee of the American Institute of Certified Public Accountants is about to call for breaking out more detailed financial results



of a company's divisions. Most corporations prefer to glom them together. That way, shareholders don't know when strong units support management-favored weak ones.

Other disclosure proposals

SLUGFESTS

TO HAFT AND HAFT NOT

A major plot point approaches in the saga of the Haft family fight for control of Dart Group: On Sept. 30, outside directors, who for now are running Dart, will decide on the validity of stock options that patriarch Herbert granted son Ronald when they were allies last summer. These days, they're at odds.

If upheld, the options would give Ronnie, Dart's president,

THICK WALLET

PAYOFFS AT A DOWNSIZED DEC

Restructuring is painful, what with layoffs and plant closings, but it can be lucrative work. Take Digital Equipment, whose \$2.1 billion loss for the fiscal year ended July 2 is its second-worst ever. Total pay for its five top execs rose 70% in that year.

from the accountants include discussing fully the risks of such exotic financial instruments as derivatives and off-balance-sheet financial arrangements. One novel idea: Produce a separate fourth-quarter report instead of lumping the numbers in with the annual report's results.

The organization's thinking carries weight with the rule-making Financial Accounting Standards Board and the SEC. But a panel of the Financial Executives Institute says there are more than enough data out there. *Michael Schroeder*

a 44% stake in the company with Herbert's reduced from 52% to 33%. Dart Chairman Herbert set that up to make his assets less attractive in a divorce from Gloria Haft. Herbert wins, he's likely to oust Ronnie. A win for Ronnie means no one will have control, and insiders say the board might appoint one of their own as chairman.

So Ronnie has sought, thus far in vain—to win back his estranged mother Gloria and sister Linda, both owners of Dart stock. Should he cobble together a victory, he may try to sell off the empire his father created. He has hired law firm Skadden, Arps, Slate, Meagher & Flood to help do a breakup valuation. Dart has real estate around Washington, plus stakes in Crown Books, Tru Auto, and Shoppers Food Warehouse. Currently, Dart trades at \$80 per share, but analysts say it could fetch \$200 broken up. *Mark Lewyn*

A just-released proxy say expanded duties for Vice-President Enrico Pesatori earned him an 18% raise in the new year, and Charles Christ got one of 35% to lead a new unit. CEO Robert Palmer got no cash raise, but directors awarded him stock options. Since Wall Street optimism on DEC is boosting its stock lately, Palmer has a paper profit that exceeds his \$900,000 salary.

Execs shed in the restructuring didn't do shabbily. Earlier this year, sales head Edward Lucente walked away with a \$630,000 settlement and consulting chief Gresham Brebach Jr., \$500,000. Outside director and Compensation Committee Chairman Thomas Phillips decline comment. *Gary McWilliam*



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LOST IN THE TRANSLATIONS

Among the biggest problems of converting from socialism to capitalism in the former Soviet bloc is the lack of a free-enterprise vocabulary.

What do they mean by this detekuityrasho?



The Moscow office of U.S. shipping outfit Sea-Land wanted to draft a brochure detailing its "customer service." Confused, a Sea-Land Russian staffer asked: "Is

that the same as the Customs Service?"

In America, government bills are short-term obligations and bonds are longer-term. In Russia, the definitions sometimes got transposed, confusing Western investors. Russian translators also have trouble with the difference between a commodity and a stock exchange. And it takes three sentences to define the alien concept of "cash flow." Another source of bafflement to Westerners and natives is the new practice of adopting English terms phonetically: "detekuityrasho" means "debt-equity ratio."

Recently, a potential investor in London asked Peter Zwack if his Hungarian liquor company, called Zwack, would name any "nonexecutive directors." Said Zwack: "No, all the directors in this company work for a living." *Patricia Kranz and Karen Lowry Miller*

GENERATION Y

NEXT, A 12-YEAR-OLD LARRY KING?

KidStar, a Seattle call-in radio station for the younger set, is pushing to go national. Owned by a group of private investors and benefiting from software giant Microsoft's and retail chain Nordstrom's funding, it just announced plans to sign up

dience, logging 800,000 youngsters' phone calls.

Kids aren't put on the air live, for fear they'll clam up or won't be understandable. Their calls are taped and edited. Parents must consent in writing before a child's voice is used. Kids ask for advice about problems, report on what they do for play, and confess safety mishaps. Example: a 5-year-old cyclist tells how he was hurt in a fall because he wore no helmet. Adult announcers—some have squeaky voices such as the Weather Squirrel's, others don't—give kid-level versions of the news. The objective is to be upbeat, "cool," and not teacherly.

KidStar airs from 6 a.m. to midnight. That's late for most listeners, but KidStar says it reaches those who are sick or can't sleep. *Dori Jones Yang*



BIG TALK: Kids are often looking for advice.

stations in 10 big U.S. cities by next spring. That way, KidStar figures it can attract lucrative national advertising; it only gets local ads now. Since its debut in May, 1993, the station's format has been a hit with its 12-and-under au-

FOOTNOTES

U.S. sales of toothbrushes, in 1991: **\$370** million. In 1993: **\$580** million

DRAWN AND QUARTERED

IN BUSINESS NEWS, MORE RUMORS OF MERGERS AND TAKEOVERS



WASSERMAN
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SHOW BIZ

'60s ALBUM ART THAT WON'T FADE AWAY

Rock 'n' roll may be here to stay, but that memorable old LP cover art of yore sure isn't. Think of the intricate artwork on the cover of the Beatles' *Sgt. Pepper's Lonely Hearts Club Band* (1967), now stuck in the basement to fade and mold away. The art on compact-disk jewel boxes is too small to be appreciated as easily.



OLD TIMES: Lithographs of *Sgt. Pepper* for \$150-\$250

Seeking a niche in the booming rock-nostalgia market, ex-disk jockey Denny Somach, 41, has brought out

signed lithographs of old bum art. "Otherwise, if you want to know in the year 2002 what *Sgt. Pepper* looked like, you'd have to go to a museum," says Somach. Last year, he formed Musicom based in Havertown, Pa., and set out to peddle the art via home-shopping channels and music stores.

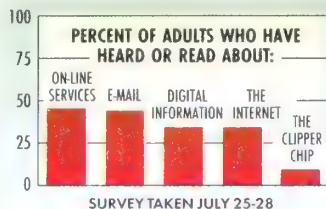
Prices vary. For the Rolling Stones' *Sticky Fingers* album cover (1971), for instance, the 23 to 300 lithographs complete with handwritten autographs

likely will go for \$2,000-plus each. For *Sgt. Pepper* or others with only machine-printed autographs, the price is \$150 to \$250.

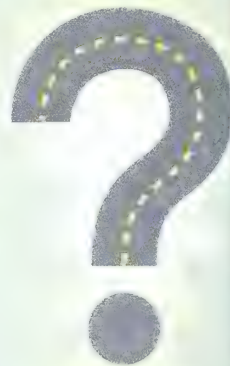
THE BIG PICTURE

SUPER INFO-WHATEVER

In April, a Harris Poll showed that only 34% of all adults had heard of the Information Superhighway. By late July, that number was 48%. But most adults still don't know much about key components of the Infobahn, the latest poll shows.



DATA: LOUIS HARRIS & ASSOCIATES





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Another IBM Client/Server Success.

Warner Bros. Studio Stores are opening about as fast as a...beep beep...*Roadrunner*, and a big part of their business is original artwork, or cels, from Warner Bros. cartoons.

"No two production cels are alike, yet each one has to be available in all of our 100 stores, simultaneously," says Karine Joret, Vice President, Worldwide Marketing.

What Joret needed was a client/server system that could 1) display cels in perfect detail, 2) be easy enough for any user, 3) make it impossible for two customers to order the same cel and 4) integrate smoothly with their existing point-of-sale system.

"We also needed a vendor who really knew retailing and could do the entire job, at our speed. It was IBM."

What IBM created is an OS/2®-based multimedia system with touch-screen PC clients in stores and a server in Burbank, all tied in to a RISC-based network for



Karine Joret
Vice President
Worldwide Marketing

point-of-sale. IBM wrote the application software and helped build facilities for digitizing images at the Warner Bros. Studios.

"Now," says Joret, "instead of flipping through photocopies, customers browse on a screen, and the instant a cel is bought it's pulled from the system, even as other customers browse in other stores. It's exactly what we asked for."

"As upcoming animated films, such as the *Roadrunner*'s 'Chariots of Fur,' create more demand for our products, our business grows and our needs change. IBM is always right there with us; I can't tell you how helpful that is."

It's another side to client/server IBM takes seriously: that you're the client, and we're the server. Call us and you'll see. That's all folks.

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PARENTS IN THE SCHOOLS ARE NO NOVELTY

In "PTA meetings? Part of a government plot" (Up Front, Sept. 5), I must correct your erroneous report that the Clinton Administration's initiative to encourage greater family involvement in education is designed to "counter critics from the far right."

You imply that this initiative is part of a newly developed strategy. But family involvement has been part of the school-improvement agenda for at least 10 years now. As Governor of South Carolina, I made it an integral part of our Education Improvement Act, passed in 1984. The law made South Carolina one of only four states to initiate strategies to help parents in their role as the principal teacher of their children. The results were gratifying. PTA membership rose steadily, and in a 1988 poll, 65% of our state's teachers said parental involvement had increased.

I must also set the record straight on the charge that our family-involvement initiative means "government encroachment" on local control of education. The initiative seeks to promote community partnerships among parents, teachers, and schools. In this way, local control will be strengthened. President Clinton and I believe strongly that locally developed solutions are the best way to improve education for our children.

Richard W. Riley
 Education Secretary
 Washington

SALVOS OF THE 'THIRD INDUSTRIAL REVOLUTION'

We believe mergers such as the ones you mention ("Mergers today, trouble tomorrow?" Top of the News, Sept. 12) are just the first salvos in the third industrial revolution described by Harvard's Professor Michael C. Jensen. But we do not agree these mergers are about efforts to eliminate excess capacity. We believe the revolution is about two things: a major paradigm shift in technology and the need for U.S. companies to compete in a global economy.

In the proposed merger between Lockheed Corp. and Martin Marietta Corp., both companies are being squeezed—by the severe downsizing of the U.S. defense establishment, by trying to maintain costly technological research and development, and by the growing pressures of global competition. Such action is critical for the survival of both companies.

The Viacom Inc. and Paramount Communications Inc. deal is also about technology: making video and entertainment products for the electronic delivery systems of the present and near future. The merger is about delivering interactive products to home and office around the globe. While Viacom and Paramount work on products for the delivery system, other deals are being explored by computer, telecommunications, and media companies with utility providers such as electric, gas, and water companies.

It is our belief that these mergers will not slow innovation—but in many ways are a result of innovation. They are not about creating monopolies, as your article suggests.

William B. Seebeck
 Managing Director
 Grant/Seebeck International
 Wilton, Conn.

THE 'DAMP RESPONSE' TO PERSONAL DIGITAL ASSISTANTS

In "PDA: Premature death announced" (Information Processing, Sept. 12), you surprisingly omitted some of the most impressive successes in the pen-based/PDA segment.

The automatic-identification industry, including Symbol Technologies, Telxon, and Norand, has successfully launched pen-based products that are targeted at vertical markets, such as health care and transportation, rather than the "mobile executive," who was the focus of most of the computer giants such as Apple Computer, AT&T, and Compaq Computer.

The damp response to the Newton and EOs proves the consumer will not "swallow technology for technology's sake." Today, and more so in the future

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Sanwa Bank

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*FORTUNE, August 22, 1994

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Subsidiaries: Sanwa Bank Canada

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I take it p

"Environmental issues are often controversial. I try to take the politics out of it. I'm an engineer. The solutions I propose are based purely on facts. Technical and scientific facts. To me, governmental

agencies or action groups are not the enemy. They are our partners in managing the environment. We may not always agree, but we all have the same goal. They know I care about the environment.

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Mariam Tehrani, Manager of Environmental Affairs, Chemicals North America:

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up. When I do, the company listens because
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CREATING THE RIGHT CHEMISTRY



AKZO NOBEL

Readers Report

the consumer will invest in technology that is economically justifiable.

Girish Rishi
Industry analyst
Venture Development Corp.
Natick, Mass.

GOLD FOR THE GOLDEN YEARS

Your article "The economics of aging" (Cover Story, Sept. 12) discusses many positive factors about our financial future. The authors place great hope in the growing savings rate and the extended working life of baby boomers. They fail to consider, however, the effect of downsizing, rightsizing, and outsourcing on this group.

A downsized baby boomer will have reduced ability to "pour billions of dollars into retirement savings plans and mutual funds" and will have great difficulty finding a job that will replace lost income or that will last until the new, delayed retirement date.

This situation will create a new class of educated, though poor, workers—who will be more dependent than ever on Social Security. To compound the problem, their reduced incomes will not be available to fund Social Security.

John M. Blocher
Spring, Tex.

Missing from your relatively well-written article are the effects of the budget, trade deficits, and a declining currency on the future economy. Most people agree that those over 65 should live the highest quality of life for as long as they can—but at what cost to future generations? The authors appear to view this subject in a vacuum, as does the leadership of the American Association of Retired Persons. The federal budget deficit has not been significantly addressed in more than a decade, which raises the concern about lowering the standard of living of future generations in order to raise artificially the standard of living for the current generations through deficit spending. The Information Revolution may increase productivity, but can it create the wealth-producing industries that can restore and revitalize a decaying middle class for the coming generations?

Also, how can anyone project bright financial scenarios for the future when the average citizen's purchasing power continues to decrease year after year? It's time to take off the rose-colored glasses.

James H. Nicholas
Sellersville, Pa.

As a boomer in his prime, I was heartened by your article on our retirement prospects. But your feature should have offered a few ideas to our legislators on measures that could stimulate personal retirement planning. I work for a small company with no retirement plan of any kind, and the president has absolutely refused to establish even a 401(k). So I'm on my own.

We desperately need legislation that frees employees of small companies (the vast majority of workers!) from the limits of the archaic IRA plan. Two thousand dollars a year maximum—what a joke. That won't even cover incontinence pads.

Hunter McCleary
Vienna, Va.

Your story states that "the primary force pushing health costs ever higher in the U.S. is technology, not demographics." Recent studies by the Health Care Technology Institute and Project Hope, studying both the cost and use of technology, estimate that between 1980 and 1990, when personal health-care spending rose 10.3%, new technology contributed only 1.6 percentage points annually, or about 15% of the total increase in health-care spending—hardly a primary force pushing costs ever higher. Technology is not a cause but a solution.

Thomas M. Loarie
Chairman and CEO
KeraVision
Fremont, Calif.

A CLEARER VIEW OF EMERGING COMPANIES

I read the story on the American Stock Exchange's Emerging Company Marketplace ("Did the Amex turn a blind eye to a 'showcase' stock?" Finance, Sept. 12) with interest. But consider this: The return on an equal-weighted portfolio of these dogs is 32.6%. Skewed though this number is by the enormous 1,542.1% return on Three-Five Systems, it is still greater than the 23% return on the Russell 2000. As my business school professor used to say: "Diversification forgives most investing mistakes."

Jags Dubashi
Mountain View, Calif.

While the table accurately depicted North Coast Energy Inc.'s current share price compared with the date we listed on the Emerging Company Marketplace, you did not note that North Coast left the ECM on Apr. 6, 1993, and relisted on NASDAQ.

We are certainly not alone in this situation, but I would ask the question:

How do small companies, including North Coast, that are profitable and growing attract capital and support there are no ECMS?

Garry Regan
Cleveland

Your table "The class of 92: Most a flunking" includes "Intertel Communications" as a member of that class. That Canadian corporation was unrelated to our company, Inter-Tel Inc., and our major telecommunications subsidiary, Inter-Tel Communications Inc.

The Intertel Communications listed in your table has changed its name to IntelCom Group Inc., a corporation in British Columbia.

Please help us to correct the confusion between our 25-year-old telecommunications company and this new comer.

Ralph Mars
Secretary
Inter-Tel Inc.
Chandler, Ariz.

THE SENATOR IS NOT FOR BURNING

Your article "Phil Gramm: A slash-and-burn artist's White House quest" (Washington Outlook, Sept. 12) did not meet the normally high standards of fair, objective journalism business leaders have come to expect from your magazine. Senator Gramm is extraordinarily intelligent, principled, and creative. He believes that big government and high taxes rob each of our citizens of the opportunity to be all he or she can be. I recommend an unbiased reporter travel with Senator Gramm and see how he and his agenda are received outside Washington.

Fred Meyer
Chairman
Aladdin Industries Inc.
Dallas

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A PIECE OF THE ACTION: HOW THE MIDDLE CLASS JOINED THE MONEY CLASS

By Joseph Nocera

Simon & Schuster • 464pp • \$25

IN PLASTIC WE TRUST

The world changed radically in September, 1958, when Bank of America mailed its first BankAmericards—forerunners of Visa cards—to 60,000 customers in Fresno, Calif. No one had asked for the cards, and no one was quite sure what to do with them. They were such an oddity that people would crowd around a cash register to see someone use one.

The credit cards gave the citizens of Fresno an option they never had: With every purchase—not just those from a few card-issuing department stores—they could choose to pay up at the end of the month or pay in installments, with interest. That choice, which millions of us now face monthly, was the first shot in the money revolution—the beginning of sweeping changes that have given ordinary Americans credit on demand, high

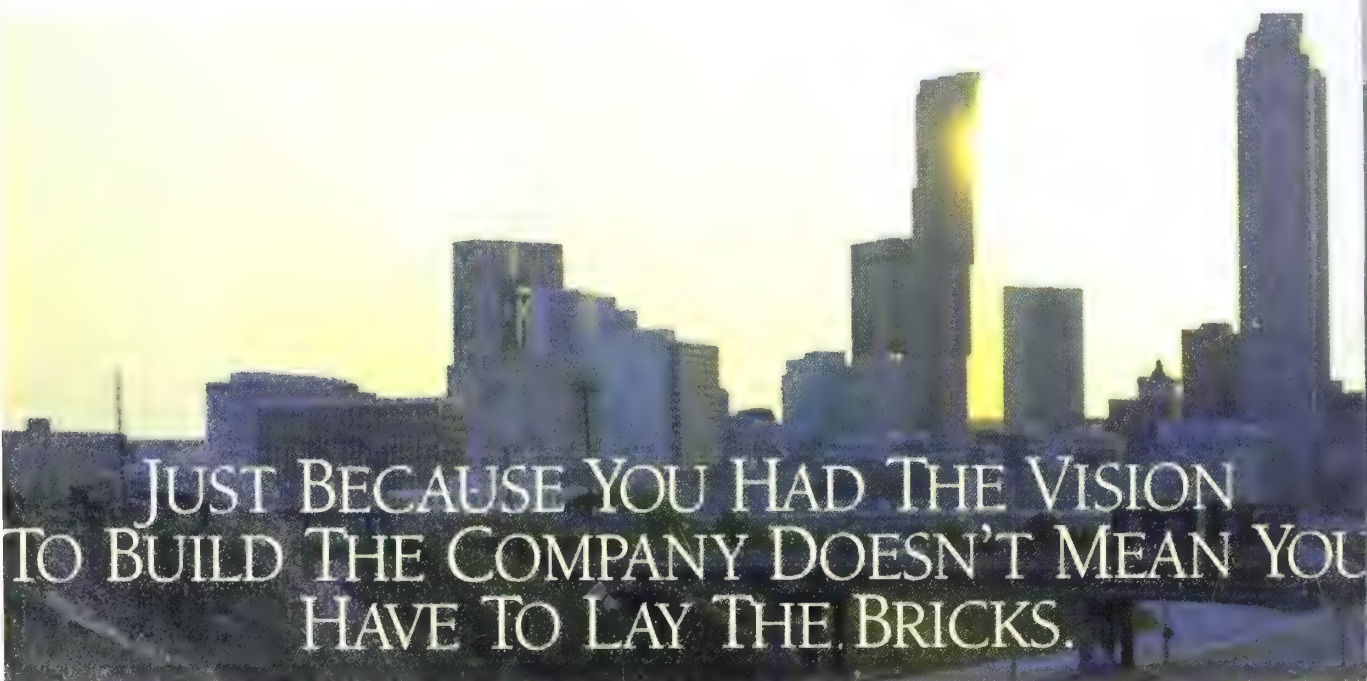
rates of interest on savings, and unending investment opportunities.

In his richly detailed and thoroughly documented *A Piece of the Action: How the Middle Class Joined the Money Class*, Joseph Nocera chronicles the transformation of personal finance through the stories of the innovators who fomented it. There's John Reed, chairman and CEO of Citicorp, who holds that position—and was able to hold on through tough times—because he led the bank into the highly profitable credit-card business in the '70s and '80s. There's Charles Schwab, whose discount stock brokerage was so appealing to investors that it succeeded despite chronic chaos. There's Edward C. "Ned" Johnson, who built Fidelity Investments into the nation's largest mutual-fund company, and Peter Lynch, his star portfolio manager.

Nocera turns up enough tidbits about these figures to keep his narrative fresh. But even more fascinating are the people who wrought profound changes yet remain relatively obscure. Among them are Joseph Williams of Bank of America, who developed the all-purpose bank-issued credit card, and Dee Ward Hood, who wove the interbank network that made the card as good as cash—and who for years ruled Visa like an emperor.

One of Nocera's quirkiest characters is Andrew Kahr, a stringy-haired management consultant who comes closest to anyone in the money revolution to being a bomb-thrower. Kahr, writes Nocera, "considered the traditions and regulations of American finance irrelevant since his mind instinctively rearranged things in patterns he found more meaningful." So Kahr, consulting for Merrill Lynch & Co. in the mid-1970s, rethought the custom of organizing people's finances into separate banking and brokerage accounts. He created the cash management account, which encompassed investments, checking, and credit cards.

Looking back, the phenomenally successful CMA seems an obvious development. But to make it work, Kahr had to not only find holes in the regulator



JUST BECAUSE YOU HAD THE VISION
TO BUILD THE COMPANY DOESN'T MEAN YOU
HAVE TO LAY THE BRICKS.

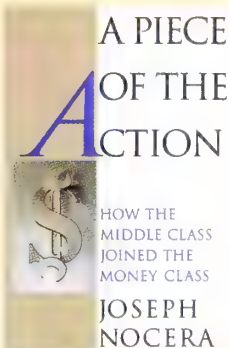
And just because you need network solutions doesn't mean you have to build the network. Advantis offers a full spectrum of Network Outsourcing solutions, structured to save you time, money and resources. Selecting the right outsourcing partner is critical, and since networking is our only business, Advantis has the experience to be that partner for you. We already provide a wide range of network solutions, including Internet access, Network Services like leased line, dial and wireless connectivity, high

bandwidth data and voice applications, and E-mail and EDI messaging services to more than 13,000 companies and 1.5 million users. And as part of the IBM Global Network, Advantis can link your company to customers and business partners in 700 locations covering more than 90 countries. The expertise of 3,000 skilled networking professionals can develop the right voice and data network solution for your company. We can design, implement and operate your network, allowing you the freedom

ces separating banking and brokerage but also d banks and brokers ling to challenge the tus quo. Nocera tells an unnamed Merrill her-up who ordered e young executive arged with promoting to "sink it in the At- tic" by spring. But the duct prevailed because its merits and because the enthusiastic sup- t of then-Chairman— d later U.S. Treasury etary—Donald Regan. Sweeping social and omic changes, Noce- acknowledges, had as ch to do with the new order of per- al finance as these pathbreakers. The ney-market mutual fund, which gave vers access to far higher rates of re- n than those offered by local banks, ight not have caught on had inflation d interest rates not soared in the '0s. And for credit cards to take hold, Americans had to shake off their aver- n to debt.

While Nocera terms the money revo- lution a "force for good," he doesn't re- rd all the players as heroes. For in-

In Nocera's eyes,
*credit on demand and
a stream of investment
options have given us
both power and angst*



stance, he chides Marshall Loeb, former managing editor of *Money* magazine, for featuring stories that promised ways to, say, turn \$50,000 into \$250,000 in five years without detailing the risks. While Loeb was hardly the only bullish journal- ist around, he had perhaps the least so- phisticated readers. "The money revo- lution," notes Nocera, "did not promise... that middle-class Americans would get rich."

What exactly, then, did the revolution achieve? Yes, members of the middle

class gained more control of their financial lives. But in his conclusion, Nocera says the new options are more of a burden than a joy, a further complication in already complicated lives. Even when people prosper, he argues, they're worried—that the market will turn, or that someone else is doing better.

Perhaps we haven't lived with the new order long enough to make that judgment. Sure, it's easy to get lost in the world of investments or max out all your credit cards. But would anyone really want

to trade today's choices for a passbook savings account with an interest rate set by regulators? My guess is that, as our expertise and ingenuity in handling financial products improves with time, most of us will be better off for having embraced them. And when the next history of personal finance is written, there will be no question: The money revolution was worth the angst.

BY JEFFREY M. LADERMAN

Senior Writer Laderman is a (credit) card-carrying member of the money class.



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EDITED BY STEPHEN H. WILDSTROM

SCANNERS SCALED TO THE DESKTOP

If you're like most business-people, there are probably a lot of things on your desk you wish were inside your computer. It would be nice, for example, to quote at length from that consultant's study in your report without retyping the text. That graph you saw might add some punch to a presentation. And the ability to feed in a copy of a letter could turn your modem-equipped computer into a full-fledged fax machine.

What you need is a scanner—the tool that moves text and images from paper to your hard disk. Long the property of libraries and graphics shops, scanners are moving onto the desktop. Traditional flatbed scanners—the size of a laser printer—claim too much real estate, but a variety of smaller devices can find space on an executive's desk.

By itself, a scanner only converts an image on paper into its digital equivalent. For drawings or charts, that's enough. Software lets you resize the image, then incorporate it into your documents. But it's much more complicated to turn printed words into text you can edit in a word processor. Your PC needs something called optical character recognition (OCR) software to translate the scanner image into data the word processor can understand.

EASY DOES IT. Unfortunately, OCR is far from perfect, and even 95% accuracy leaves a lot of missed or misread characters to be fixed by hand. While a good spell-checker can be a big help in cleaning up text, you have to be very

careful when proofreading numbers. OCR also demands a fast PC with lots of random-access memory. That said, I've found that a scanner can be a blessing.

Logitech's budget-priced ScanMan is the best-known handheld scanner for Windows. (The Caere OmniScan

specialized approaches. The DataPen is a six-inch-long device that plugs into the printer port of your computer while still allowing the use of the printer. You hold it like a pen and scan text one line at a time. An OCR program deposits the scanned text directly in your word processor or other Windows program.

It helps to be right-handed. I'm a lefty, and I found the DataPen extremely awkward to use. But my right-handed son found it a pleasure. The U.S. distributor for the Belgian-made device says work is being done to make the DataPen more southpaw-friendly.

PaperMax is a 12-inch-long sheet-fed scanner that claims hardly any space on your desk. It plugs into a serial port, making its installation the easiest of the devices. Feed a sheet of paper into the slot on the front of the PaperMax, and within 10 seconds, the scanned image will appear on a Windows screen (a Mac version is due this fall).

PaperMax is not primarily designed for text recognition, though you can buy OCR software for it. Its strength is quickly and easily scanning in pages that can be sent out as faxes, attached to E-mail, or pasted into your documents as images. And, coupled with a laser printer, it turns your computer into a desktop copying machine.

Both hardware and OCR technology are steadily improving, making the scanner a useful business tool. Any of these three very different units can be a valuable addition to your high-tech toolbox. S.W.



THREE DESKTOP SCANNERS

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PAPERMAX

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\$499

SCANMAN

Logitech Inc.
800 231-7717
\$199

is a similar device for the Macintosh.) It reads a swath about five inches wide, then uses software to stitch together a full-width page. Like all handheld scanners, ScanMan requires a slow, steady sweep down the page for best results. My initial efforts were disappointing, but accuracy improved dramatically with practice. ScanMan attaches to your computer via a special board that plugs into an internal slot.

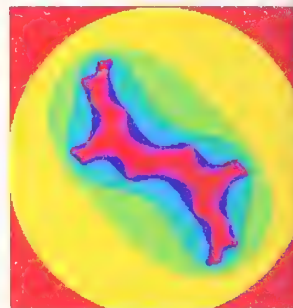
The I.R.I.S. America DataPen and the Visioneer PaperMax take quite different, spe-

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UPGRADES

POWERING UP POWER MACS

There are signs of relief from the drought in software for Apple Computer's Power Macs. Will owners of the PowerPC-based computers finally get to use some of the speed they paid for? Power Macs are notorious slow-



pokes running versions of computation-intensive programs, such as Microsoft's Excel spreadsheet, written for older Macs.

Some nonscientific testing hints at how big a boost is coming. I used Wolfram Research's Mathematica to play a fractal design called a Julia set. The PowerPC version took 14 minutes on a Power Mac 6100/60, the Mac version 3 minutes on a Quadra 800. Power Mac software now shipping includes Claris' MacWrite word processor and Impact presentation graphics. Microsoft Office, including Excel for Power Mac, should be out in October.

SCHOOL DAYS

APPLICATIONS SOFTWARE

Washington University of St. Louis is turning to technology for help in the competitive business of recruiting students. It has offered free copies of Collegelink from Enrollment Technologies to high school seniors it has invited to apply. Students can use the software, usually \$35, to apply to Wash U. and up to seven of the other 650 schools that support the program.

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HOLDING BANKS HOSTAGE IS A ROTTEN WAY TO BATTLE BIAS

BY PAUL CRAIG ROBERTS



The Justice Dept. is blocking a second institution from expanding until it settles a trumped-up redlining suit. Uncle Sam should stop creating law by consent decree and granting privileges based on race

Last Jan. 24, I predicted in this space that Shawmut National Corp.'s settlement of a sham discrimination suit brought by the Justice Dept. against its subsidiary, Shawmut Mortgage Co., would open the door for the government to commandeer the resources of private banks for political purposes. Government officials issued the obligatory denials of any such intentions, but the Justice Dept.'s Aug. 22 sandbagging of Chevy Chase Federal Savings Bank in Maryland confirms my worst fears.

A study found to be flawed by the Federal Deposit Insurance Corp. and numerous scholars was concocted by the Federal Reserve Bank of Boston. It was used to block Shawmut's expansion plans until the bank agreed to settle a discrimination suit that had no individual complainants. Shawmut was wrongly accused of denying mortgages to minority groups despite its practice of aggressively seeking mortgage business from low-income minority applicants who cannot meet the normal criteria required for a mortgage loan.

In the Chevy Chase case, the government didn't bother with a study. The Justice Dept. pronounced the bank guilty of an infraction so new that it is not even on the statute books—the failure to open enough branches in “majority African American census tracts,” as the consent decree put it, in the District of Columbia and Prince Georges County. In short, Chevy Chase was told that if it wanted to conduct business in suburban Maryland, it also had to conduct business in black areas of D.C.

COERCIVE POWER. The bank's chairman and CEO, B. Francis Saul II, adamantly denied the Justice Dept.'s unsupported charges of racist redlining. He noted that over the past five years, Chevy Chase had made more than 1,100 first mortgage and home-improvement loans in the minority census tracts that it was accused of shunning and that it maintained over \$60 million in credit-card lines to 17,000 individuals in the “redlined” census tracts. Ironically, regulators prevented the bank from expanding into a black census tract in 1989 and again in 1990, and its minority loan approval rate is 88%, far above the 69% rate by all lending institutions nationwide.

However, the Justice Dept. is not interested in facts but in what James D. McLaughlin of the American Bankers Assn. calls “developing law by consent decree.” Justice uses its power to hold a bank's business hostage in order to coerce a settlement equal to the approximate cost of the bank's legal defense. Justice then distributes the money in highly visible political ways.

For Chevy Chase and its mortgage subsidiary, this added up to opening four superfluous branches in black areas, budgeting advertising for black publications, more employment quotas, and below-market loans to blacks with interest rates “at either one percent less than the prevailing rate or one-half percent below the market rate combined with a grant to be applied to the downpayment requirements,” to quote from Justice's press release.

In other words, the bank must hand over special privileges in order to avoid being labeled racist. If the bank's executives had awarded themselves loans on such terms, they would surely have been indicted for self-dealing.

RAISING THE STAKES. Cornell University law professor Jonathan R. Macey says that “the government's willingness to proceed with litigation in the absence of evidence of discrimination... is scandalous in a nation that purports to be governed by the rule of law. Justice's behavior is scandalous because it is depraved. The government is substituting coercion for law and creating a status-based legal system in which privileges are granted on the basis of race.”

In the process of creating this new legal regime by consent decree, Justice has carefully chosen its targets and its price in order to avoid any chance that the victim will fight in court. But once the law is developed by consent decree, the stakes will change. If the basis of the Chevy Chase settlement were to be applied generally, every business with one or more branches that does not have stores in black census tracts is guilty of racial discrimination. In Attorney General Janet Reno's expanded interpretation of disparate impact, businesses without stores in minority census tracts are guilty of shunning “an entire community because of its racial makeup.”

By striking deals to rescue their businesses from being held hostage by Justice, Shawmut and Chevy Chase are permitting the Clinton Administration to establish the legal interpretation that banks, liquor stores, jewelry stores, car dealerships, and the like that do not have outlets in minority census tracts are guilty of violating the law against racial discrimination.

If banks can be forced to lend to “protected minorities” at below-market rates, then it follows that they can be forced to give interest-free mortgages. Justice is developing precedents that will permit government to extend the unpredictable forms of taxation now applicable to banks to all U.S. businesses—a development that has serious implications for their profits and capitalized values.

PAUL CRAIG ROBERTS IS JOHN M. OLIN FELLOW OF THE INSTITUTE FOR POLITICAL ECONOMY AND DISTINGUISHED FELLOW OF THE CATO INSTITUTE IN WASHINGTON, D.C.



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"A multinational client of ours needed local currency funding in China," says Shirley Ho, Corporate Banking, UBS. "Often the simplest solution is the best. But obtaining Chinese Renmenbi at short notice is not always easy. We located a Chinese company in need of U.S. dollars and quickly secured local funding for our client so they could continue growing their business in China."

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BY GENE KORETZ

AMERICAN INDUSTRY STARTS INVESTING IN BRICKS AND MORTAR

In the wake of the news that the capacity utilization rate of U.S. industry hit 84.7% in August, a significant shift in business investment is drawing new attention: After falling 27% from mid-1990 through mid-1993, real outlays for industrial construction have turned up again and are now running about 10% above year-earlier levels (chart).

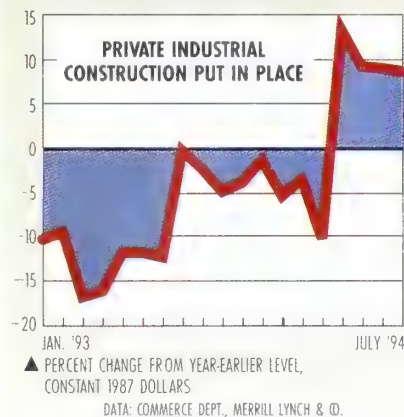
The pickup in plant expansion is welcome on several counts. For those economists who worry about high industrial

industries. "Spending for new facilities is long-term investment that reflects confidence in the durability of the expansion and the competitiveness of U.S. industry in world markets," says Jack Lavery of Merrill Lynch.

One measure of how that confidence is growing comes from Cimtek Inc., a market-research and database company in Johnson City, Tenn., that keeps tabs on new industrial projects around the country. According to Cimtek's tally, plans to build some 1,066 plants were unveiled in the first half of this year, 69% more than in the first half of 1993. And planned plant expansions were up 60%, to 772.

In sum, business is finally putting the "plant" back into U.S. plant and equipment expenditures. With a little luck, that should help dampen inflation, keep the economic upswing on track, and position U.S. industry to capitalize on the global expansion that lies ahead.

U.S. PLANT EXPANSION IS ON THE UPSWING



operating rates, added capacity promises to defuse inflationary pressures. For those afraid that Fed restraint could short-circuit the upswing, rising plant investment offers assurance that the expansion has entered a self-sustaining phase, with capital spending helping to offset the slack in housing and consumer spending.

Economists Bruce Steinberg of Merrill Lynch & Co. and Steven Roach of Morgan Stanley & Co., for example, both believe that the Federal Reserve is overstating industrial operating rates. Steinberg notes that real outlays for basic industrial equipment are up 15% this year, an increase that in past cycles would have been associated with much stronger capacity growth. And Roach argues that the Fed has failed to appreciate how new technology and reengineering of existing plants have boosted production capacity.

In this view, the new stress on plant expansion is more than a response to occasional bottlenecks occurring in a few

IRELAND'S ECONOMY: THE OLD SOD IS FERTILE FOR GROWTH

London-based economist Kevin Gardiner of Morgan, Stanley & Co. calls it "the Celtic tiger." Over the past five years, the Irish economy has been one of the fastest-growing in Europe, skirting recession and posting average growth of 5%. This year and next, says Gardiner, the pace could be even faster.

The key to Ireland's success is that it is an open economy that hews to balanced economic policies. Aided by heavy foreign investment, particularly in high-tech areas, exports have taken off. As a result, Ireland enjoys the largest balance-of-payments surplus relative to gross domestic product in Europe.

After being forced by the drop in the British pound to devalue its own currency at the start of 1993, Ireland has pursued restrained fiscal and monetary policies. The budget, excluding interest payments, is in surplus, and government debt as a percentage of GDP is declining. Inflation is being held under 3%, and the recent rise in British interest rates is putting upward pressure on Irish rates as well.

With high household savings, productivity growth averaging 4%, and modest negotiated wage hikes, the dangers of a serious upsurge in inflation seem remote. As its European trading partners shake off the dregs of recession, Ireland's export-led growth should accelerate and put downward pressure on its chronically high 15%-plus unemployment rate.

SOARING OIL IMPORTS NOW COULD HOBBLE THE U.S. LATER

While many factors contributed to the latest jump in America's trade deficit, one seems especially ominous. William V. Sullivan Jr. of Dean Witter Reynolds Inc. notes that U.S. imports of crude oil and refined products in July and August hit a record of nearly 10 million barrels a day. Such energy imports since March are up 9.2% from 1993, accounting for some 55% of domestic demand.

America's growing dependence on offshore supplies is particularly worrisome in light of the upward movement of oil prices during most of this year. Sullivan estimates that the energy trade deficit so far in 1994 is running close to \$65 billion annual level, about \$15 billion more than last year's deficit.

That trend, says Sullivan, helps explain the dollar's current weakness in currency markets. But a larger danger for the U.S. economy, he warns, may come some years away "when foreign oil producers may decide to test America's vulnerability to their pricing behavior."

CALIFORNIA'S TIMID RECOVERY SEEMS TO HAVE STRONGER LEGS

Fears that California's recovery has stalled appear to be exaggerated, contends economist David Hensley of Salomon Brothers Inc. Based on a forthcoming revision of state employment data, he predicts that the jobs picture for 1993 and 1994 will look decidedly more upbeat than the current numbers that show scant gains this year since employment hit a trough last December.

The problem is that California counts jobs created by new businesses only after it is able to verify them through actual payroll tax payments. A recent preliminary review of such payments through March of this year erases much of the job losses last year and shows a healthy pickup in February and March of this year. It indicates that the original employment count over the 12 months ending in March may have missed as many as 220,000 jobs.

Even if the final upward revision is less buoyant, says Hensley, "the new data confirm the view that the Golden State is in the early stages of a slow but broad-based expansion."

The Frequent Traveler 1994

By Paul Burnham Finney







"The changes in the QE2 can be summed up in
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I serve as Captain of the QE2. And my father was the original Captain.

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That's what Cunard has in mind with its cosmopolitan answer to business travel boredom — a cost-saving transatlantic package called the Businessman's Special.

When you book it, you sail aboard the *Queen Elizabeth 2*, a floating palace like no other ship at sea, from New York to Southampton, make your round of appointments in Britain and on the continent, and fly home in economy class or on British Airways' supersonic Concorde. You can do it in reverse — with a fly-over, sail-back itinerary — if you choose.

In any case, it's all built into a single fare, with only a modest supplemental charge for the fast-as-a-bullet flight.

Cunard has even added a sweetener to the deal: take a companion along — free.

Spa at Sea. When ocean liners began to fade away — destined for conversion to cruise ships, destruction at a scrapyard or final service as an attraction (the *Queen Mary* at Long Beach) — the *Queen Elizabeth 2* was put into service

on the transatlantic run in 1969. It was a luxurious leviathan indeed: 963 feet long, 67,139 tons, and regally appointed — with the gold, red, and Britannia blue livery of the Cunard Line. The last of the regularly scheduled liners across the Atlantic, it could carry — and pamper — 1,800 passengers.

Today, the QE2 blends superliner tradition with the lifestyle of the nineties. Resplendently refurbished for 1995 service — at a cost of \$45 million — it will boast a classic Pub with dart board and karaoke, an Observation Bar with panoramic ocean vistas, and totally renovated cabins.

You can keep trim with workouts and treatments in the QE2's SpaWorld. How about a 50-minute aromatherapy massage? Or a seaweed body wrap?

In a full day's smorgasbord of diversions, you'll find everything from hit movies to celebrity entertainment (Dave Brubeck, William F. Buckley, Jr., Bob Newhart). If you can't let go of work, you can do an occasional stint at the keyboard in the Epson Computer Center — or even get your corporate group together in the QE2's executive boardroom. For gifts and getups, browse through the QE2's array of boutiques.

To spoon this air-sea package into your business trip, call **Cunard** (800/221-4770) or a travel agent.



Cunard's opulent QE2 cruises the Caribbean in winter and then goes on the Atlantic run.

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It's just enormous — the \$135 billion American corporations spend each year on travel, according to American Express.

Some of the money is well spent. You've got to get around and do business with suppliers, customers or simply your own branch plants and offices, here in the U.S. or thousands of miles away in France or Brazil or Thailand.

"When the crunch comes — you versus a competitor — who gets the contract?" says a well-traveled sales executive. "The guy who makes the trip to San Francisco or Atlanta and shakes the hand. It can't all be done by phone or fax."

But is some of the money poorly spent?

The travel-management industry thinks it is. Born in the eighties, armed with sophisticated software, and now led by American Express, Carlson Wagonlit Travel, and Thomas Cooke Travel, the industry can pull out of its data bases plenty of statistics to prove its case.

Not Just Lip Service. "In the nineties it's the same song — but a different version," says Michael Buckman, executive vice-president, Travel Management Services, at American Express. "A few years back companies didn't see the urgency of managing

travel — or didn't feel totally comfortable with the idea. It wasn't directly related to their core businesses."

"Now," he goes on to say, "with so much attention given to reengineering and cost controls, companies aren't just paying lip service to travel management. The time has come when they see how important it is, just as they finally recognized the significance of health benefits."

With literally tens of thousands of employees traveling — in a company as large as General Motors or IBM — can you actually keep tabs on where they're going and how much they're spending? The standard answer from American Express is that travel is the "third largest controllable expense" after payroll and materials.

"We see a huge change taking place in travel management," says Christine Levite, director of TRS Communications at American Express. "We've got more and better technology — not only for making reservations or E-mail requests to travel agents but also for assisting corporate travel managers. They can see exactly who's booked what — and whether the reservations fit into a prescribed pattern."

Substantial Savings. It doesn't take long before the travel bill goes down — or at least stays about the same despite creeping inflation. "We generally guar-

Armed with sophisticated software, American Express, Carlson Wagonlit, and Thomas Cooke can keep tabs on what your road warriors are spending.

The Frequent Traveler 1994

tee you'll save between 15% and 20% better management," says Buckman, ding, "If you negotiate with vendors airlines, hotels, car-rental firms — u may be talking savings as high as 1% to 40%."

Touch-tone Planning. In fact, when u look at the financial mess that used characterize business travel and com- re it to today's computerized efficien- , you can become a true believer in avel management.

Traveling employees in the middle to wer ranks no longer have many choic-. Their corporate travel manual may quire them to fly American or Delta at e lowest possible fare (with a Saturday- ght stopover if necessary), stay at erations or Quality Inns (at a greatly duced rate), rent from Budget or lamo (with unlimited mileage and no opoff charges built into the corporate ontract), charge expenses on the merican Express Corporate Card — d file detailed expense reports, with ackup receipts, within seven days of eir return.

For its clients, Thomas Cooke pro- des a variety of software packages — me to assist employees in booking ips that keep within corporate guide- nes, others to help bosses monitor ravel compliance."

Now, with no more than a touch-tone hone and a computer program called homas Cooke Express, you can pull up l sorts of information from a computer reservation system to help you create a itable business-trip itinerary.

"One of the keys to tracking expens- s is quality assurance," says Richard 'Ambrosio, public-relations director of homas Cooke. "Our Expert Agent oftware, for example, helps automate e arrangements for a business trip. lmost everything goes through a com- puter to be sure it's done properly. e will even do nice things like check whether you've been wait-listed to

move up from business to first class."

Cash Controls. Expense management is as critical as travel purchasing.

But it's tricky trying to staunch the flow of cash advances, which can do major damage to travel budgets.

"Most companies provide traveling employees with three times as much cash as they need," says Levite of American Express, noting that among the tools to help control advances is the new Corporate Travelers Cheque. "Your boss gives you a packet of checks, but it's not charged to your company until you use them."

For travel-management companies the next big step is to expand and refine their overseas services in line with the "globalization" of business.



Amer's Michael Buckman:
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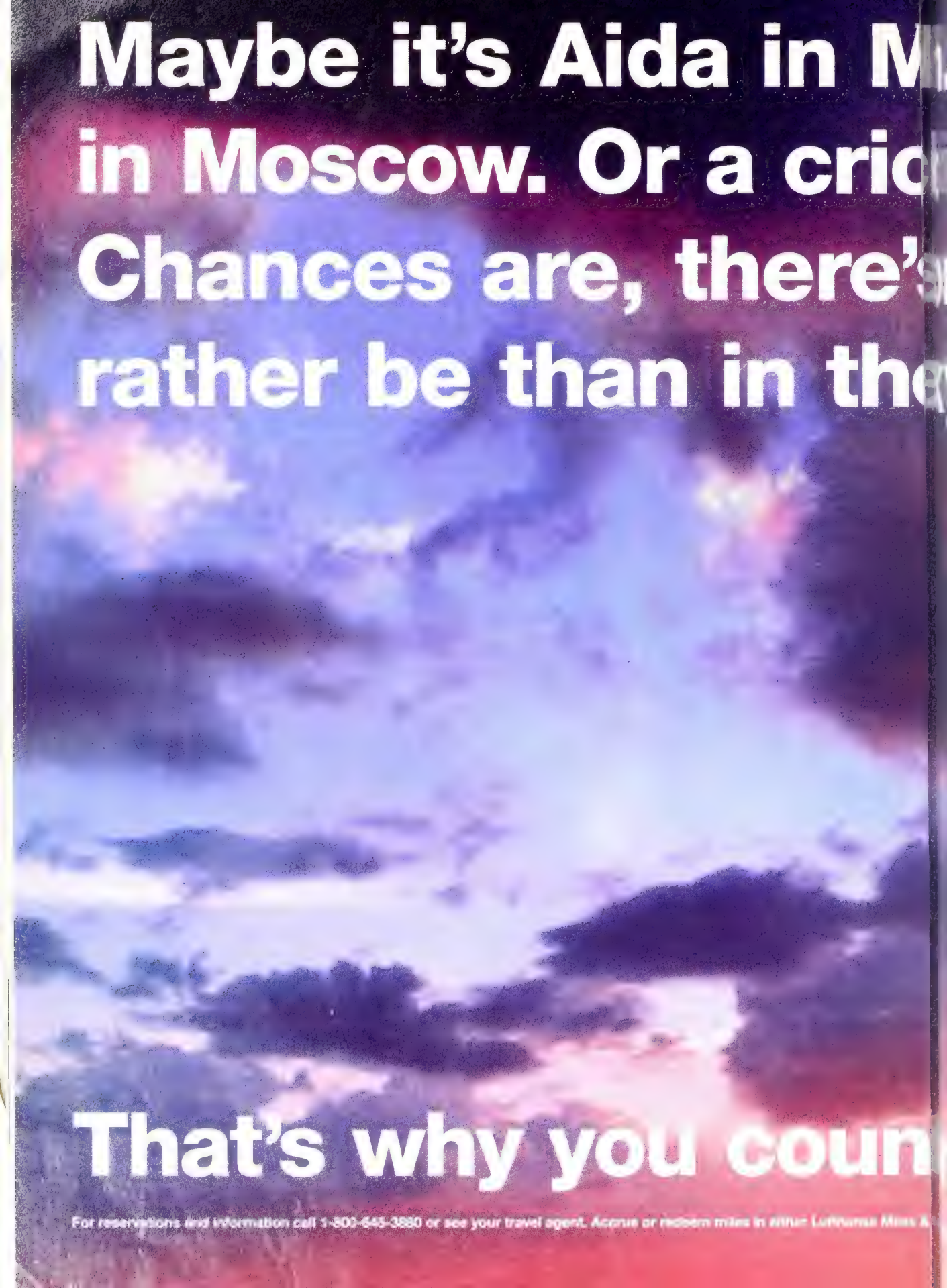


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Go for it. On your swing around Europe's business centers next spring, take the train rather than plane between London and Paris or Brussels. It's not just the curiosity of seeing what the new 31.5-mile Chunnel, the rail tunnel under the English Channel, is like. Downtown to downtown, the three-hour *Eurostar* train trip will be about as fast as the combined one-hour shuttle by **British Airways** (800/247-9297) or **Air France** (800/237-2747) and the airport-city schlep at each end. And you can write memos, work on your laptop, and dine while taking in the countryside of East Anglia and northwestern France.

In the Chunnel fog of often contradictory information, it now looks as though the specially designed, 18-car *Eurostar* trains, which now run erratically, will begin meeting regular schedules by next March or April. The prime movers behind *Eurostar* are **BritRail** and France's **SNCF**, as well as the Belgian National Railway. You'll board at Waterloo in London, Gare du Nord in Paris, and South Station in Brussels.

...AND BY RENTAL CAR

You can also rent a car in either London or Paris and take it through the Chunnel.

"You never could do this before," says Peter Rasmussen, division vice-president, international, for **Hertz** (800/654-3131), which is starting up the new system this fall. "You had to sail or fly to the continent and then pick up a car."

Here's the Hertz drill:

Rent a car in London (it could be Paris coming the other way) for a minimum of one week. Drive to appointments, throw in some sight-seeing if you like. At Folkestone, after going through minor customs procedures, put your rental on *Le Shuttle*, a double-decker auto-and-truck train operated by Eurotunnel, the British-French consortium that built the Chunnel. Shuttles depart about every 15 minutes. You and your passengers stay in the car — or in a small sitting compartment.

At Calais, drop off your right-hand-drive car and pick up a comparable standard-drive rental at the Hertz counter. "You sign a slip of paper," says Rasmussen, "and that's about all — there's no writing up a whole new contract. And away you go on the road to Paris".

The price of your week's package (rental, insurance, Chunnel passage) for a small compact is quite attractive — roughly \$300. "You rent the car and make the crossing for less than if you simply bought a *Le Shuttle* ticket," adds Rasmussen. "And it's not far off the ferry price — with the advantage that the trip takes 20 minutes in the Chunnel but an hour if you're on the ferry."

CORPORATE CATNAPS

If you're ready for a nap between plane connections — or in need of some short-term office space — try one of the eight **Ziosks** (800/367-7050) installed along the concourses at Minneapolis-St. Paul International Airport. Most of the rooms are seven by nine feet and

Can you spot the one who flew Northwest?



In some circles, as it turns out, arriving late is not particularly fashionable.

Which is why businesses that run by the clock count on an airline that does the same: Northwest Airlines. For the fourth consecutive year, Northwest has been the number one on-time airline among the seven largest U.S. carriers*.

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And, when and if they arrive, suggest to those around you that they do the same.

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*Report by Department of Transportation, based on report by Department of Transportation, Bureau of Transportation Statistics, for the period ending December 31, 1994. On-time performance based on flights to and from the United States.



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The navigation screen on a Delta 88 dashboard tells you where you are.

come equipped with a couch, reclining chair, work table, credit-card swipe phone, fax machine, TV, clock radio and air-conditioning. Rates are \$12.95 for the first hour, \$6.98 for each additional hour. You can book ahead of time or simply check in at the last minute by using the direct-line phone just outside the front door. Payment is by credit card — no cash allowed (partly to make sure rooms aren't used for illicit purposes).

YOUR COMPUTERIZED CHAUFFEUR

The most recent big breakthrough in car renting was the cellular phone. It turned your car into a mobile phone booth. The next mini-revolution may well be computerized mapping to help you get where you're going.

So, more than Avis (800/331-1212) is watching as the Number Two car-rental company puts a Navmate satellite navigational system through its paces in one-hundred Olds Delta 88s it's renting at San Jose International Airport.

Navmate's high-tech gadgetry is an interactive, "intelligent" system not unlike a personal computer. There's a tiny TV screen on the car's dashboard and a bunch of buttons (Enter, Options, Assist, Cancel) you touch, plus audio for certain instructions.

The crux of Navmate is the new hot gimmick that's exciting everyone in consumer electronics — a Global Positioning Satellite System (GPS). Tell Navmate where you are (the Avis parking lot at San Jose) and where you want to go (say, St. Helena in the Napa Valley), and GPS figures it out from there, including all the locations along your route, from towns to intersections. The TV screen pictures where you're going, street by street, as you drive.

Brainy as it is, the Navmate system is only as good as the highway and street data fed into it.

"We'd like to roll out Navmate — or system like that — in 1995," says Terry Gordon, public relations manager of Avis. "But it all depends on how fast the mapping company can finish doing the entire nation."

WHITE-GLOVES SERVICE IN THE WEST

If you're a commuter on the Pacific Rim circuit, you undoubtedly know about the strategically located business hotels run by Pan Pacific (800/327-8585) in 14 countries, from Auckland to Wuxi near Shanghai. Opening this year are the Glenmarie Resort (three golf courses) in Kuala Lumpur, Malaysia's business capital, and the resort-style Pan Pacific (loaded with voice-mail facilities) near offices in Bangkok.

Before flying off to the Far East, you can enjoy Pan Pacific's white-gloves business service in three West Coast hotels: the Pan Pacific a block from Union Square in San Francisco and designed by atrium architect John Portman, the more family-oriented Pan Pacific next to Disneyland and the Convention Center in Anaheim, and San Diego's Pan Pacific, ensconced at the spectacular, seven-tower Emerald-Shapery Center and especially suited to corporate meetings. And enticing corporate rates make the stays easier.

ARCADES ALOFT

First came audio entertainment with headphones plugged into your armrest, then Airfones lifted out of seatbacks with the swipe of a credit card and, more recently, personal micro-TVs on swivels in first class. You haven't seen anything yet compared to the home-and-office arcades that airlines, from United (800/241-6522) to Singapore (800/742-3333), and Taiwan's China Airlines

Opening this year are the Glenmarie Resort in Kuala Lumpur and the resort-style Pan Pacific near offices in Bangkok.

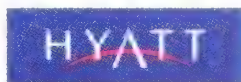
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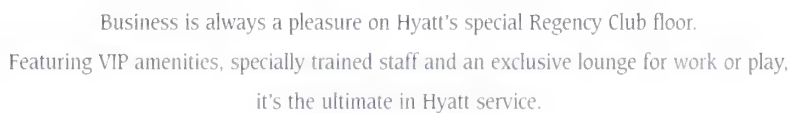
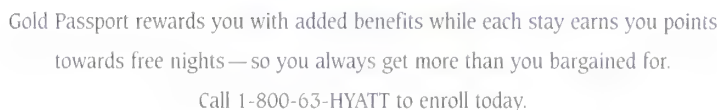
At Hyatt, overnight success stories are business as usual—thanks to Hyatt Business Plan. You can take advantage of a personal work space and desk phone with no phone access charges,* in-room fax,** and 24-hour access to photocopiers and printers on your floor. As well as express breakfast and a morning newspaper. A terrific value considering Business Plan is just \$15 over the regular room rate. After all, nothing makes you feel better in the morning than a good night's work. Call your travel planner or Hyatt at 1-800-233-1234.



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/227-5118), are rushing to install at seat. First class and business class, of course, are first in line to enjoy the fun games. With the sound track coming through earphones, you'll watch the action on a tiny TV screen in the seat-back in front.

Pioneering the art of entertaining passengers electronically is **Northwest** (800/225-2525), which has some eight jumbo jets outfitted with high-tech gadgetry and 25 more on the way. At the touch of a clicker, you can access a shopping catalog, a movie of your choice, a variety of Nintendo games, and all sorts of information about your flight and destination — weather, estimated arrival time, gate number — as well as order food and drinks. The games cost \$4 an hour — a bargain considering the 50¢ fee to play one game in a pizza parlor — but most of the other services are free.

Leader among foreign carriers, Germany's **Lufthansa** (800/645-3880) is teaming up with British Telecom to provide around-the-world satellite communications with its executive passengers. In 1995 all its Airbus and Boeing jets on the transatlantic run will have seat phones and on-board faxes that will work globally, even over water. With an interactive screen at your in-seat video in first and business class, you'll be able to book hotels, car rentals, and airline tickets — and enjoy a whole range of new entertainment options on top of the 16 channels you can already access, from news to movies.

PASSING THE FRONT DESK

Amazing it is that business travelers can have their worst moments simply trying to get to the hotel rooms they've booked. The villain: check in gridlock. It's no wonder that top hotel chains like **Hilton** (800/445-8667) and **Marriott** (800/228-9290) are coming up with systems to pre-register guests and provide

special check in desks.

In the Age of Automation, Hyatt's notion of totally bypassing the front desk sounds like an idea whose time has come. At least, the upscale chain thinks so as it runs guests at its **Hyatt Regency O'Hare** (800/228-9000) and **Hyatt Regency Atlanta** through a state-of-the-art ATM procedure, partly developed by Andersen Consulting and called Touch and Go Instant Check in, that picks up where bank ATMs left off.

To give its "front desk" a user-friendly, familiar image, Hyatt has its check in robot look and act like an automated teller machine. You insert your credit card and confirm your room preference and other information that pops up on the screen. Then, dutifully, the machine dispenses room keys as well as a printed passport with a room number. Check out is just as easy. Presto, the bill of particulars for your stay shows up on the screen. (Yes, you can do that at many hotels on your guest-room TV, but still have to go to the lobby to get your bill — or wait for it to come through the mail.) With an approving nod, the ATM prints out a folio of charges in a flash.

GETTING A GOOD DEAL ON A FACTORY-PICKUP CAR

If you're shopping for a classy European car in the \$20,000 to \$40,000 range, you can lower the sticker price as much as 10% — or more — by taking delivery on the continent during a business trip.

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By now, however, European car makers have put most of those problems behind them and, with a modestly appropriate to the 1990s, are continuing to push sales of cars paid for at your local dealer (including U.S. sales and luxury taxes) but ready for convenient pickup in a number of European cities.

The savings, though far lower than those of thirty years ago, are noteworthy — at least in 1994 terms when every little bit counts. In a representative list of models, ranging from very high price tags, you'll save the following on a European delivery — at October 1994 prices:

Volvo 850 Turbo, \$4,045 (12.4%); Saab 900, \$2,550 (11.3%); Volvo 944, \$2,390 (14.4%); Mercedes SL600, \$12,000 (10%); Porsche 968, \$3,995 (10%); Saab 9000, \$8,700 (10%); Porsche 911 Carrera, \$18,180 (8.6%); Audi 90S, \$2,396 (8.6%); Volkswagen Cabrio, \$1,002 (5%). Drive safely so you can enjoy your new car back home.

KNOWING WHAT YOU'RE GETTING

Even essayist Ralph Waldo Emerson cracked "foolish consistency," he definitely did not have the traveler of the late 19th century in mind. Coming off a long trip, arriving at a hotel, beat and slight-

ly bewildered, and not knowing what's what is an invitation to stress.

That's why the recent move by Marriott (800/228-9290) to make core services and perks consistent at its 207 U.S. hotels is a boon to business travelers.

For openers, the efficiency-minded chain is eliminating the 75¢ access fee for collect and credit-card calls that has irritated guests. "Our customers told us loud and clear that access fees are inappropriate," says William R. Tiefel, president of Marriott Lodging.

In addition, you can now count on finding eight other services and extras standardized at Marriott's domestic hotels:

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In a recent survey of 700 business travelers by ConsumerMetrics, Marriott won top honors for service, quality, cleanliness, and check ins and check outs.

Clearly, consistency isn't "the hobgoblin of little minds," as Emerson put it.

This text was written by Paul Burnham Finney of Finlyn Communications, Inc. Mr. Finney is a well-known journalist with expertise in worldwide business travel.



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5 ☐ Finance, Insurance, Real Estate 6 ☐ Government 7 ☐ Transportation, Public Utilities
8 ☐ Service Industries 9 ☐ Other - Please Specify:

2 What is your title?

- A ☐ Chairman of the Board B ☐ President C ☐ Vice President D ☐ Treasurer, Secretary
E ☐ General Manager F ☐ Division Manager G ☐ Department Manager H ☐ Other Manager
I ☐ Student J ☐ Other - Please Specify:

3 How many employees in your company worldwide?

- 1 ☐ Under 100 2 ☐ 100-999 3 ☐ 1,000-2499 4 ☐ 2,500 - 4,999 5 ☐ 5,000 -9,999 6 ☐ 10,000 or more

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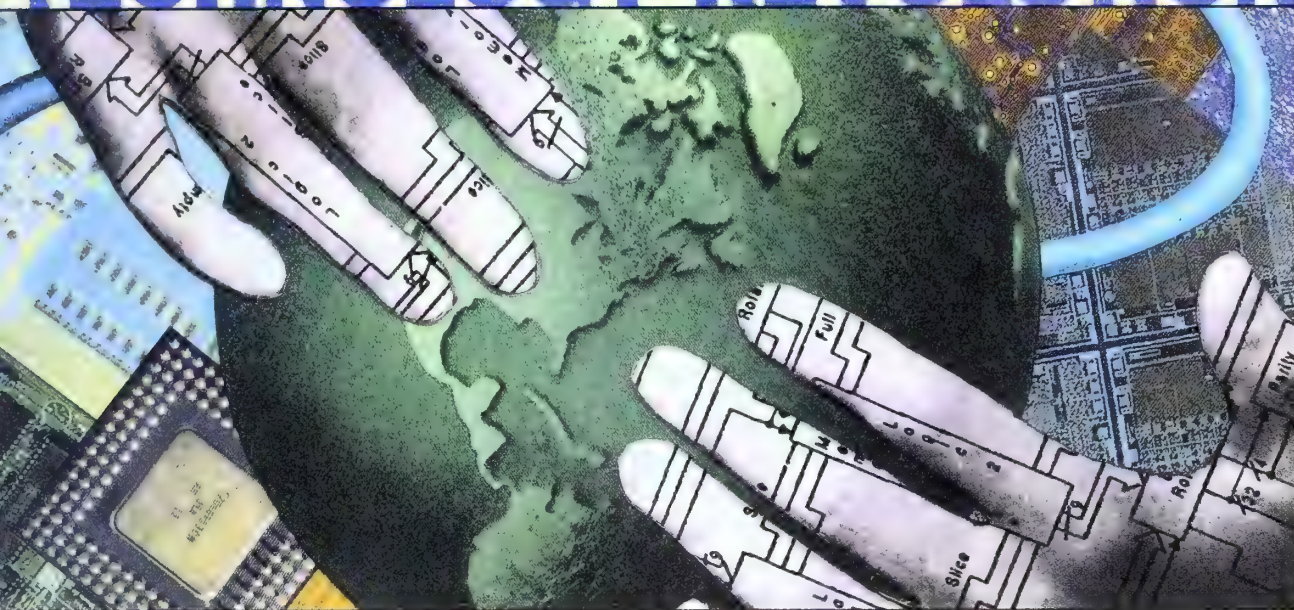


Illustration by Victoria Kann. As seen in BusinessWeek, May 23, 1994 Issue

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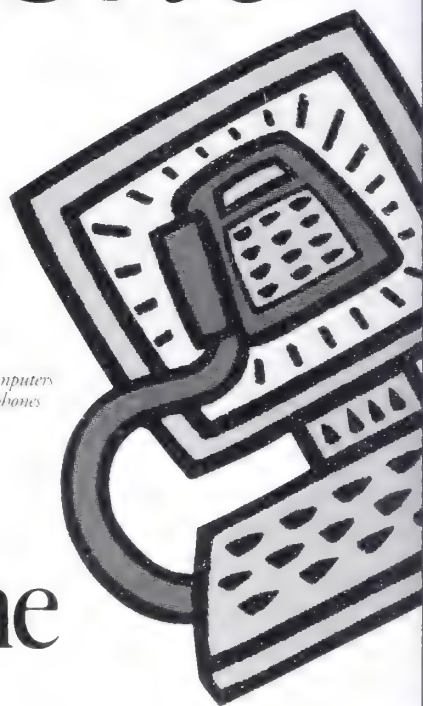
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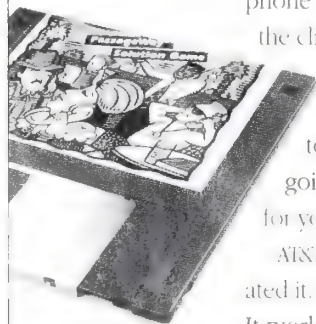
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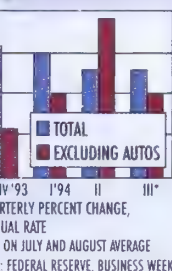


FULL-TILT FACTORIES AREN'T AS SCARY AS THEY LOOK

the U.S. economy is slowing down in the second half, it looks as if someone forgot to tell manufacturers. In August, production soared, output in previous months revised up considerably, and factories used their capacity at the highest rate in more than five years, a levety associated with production bottlenecks and price pressures.

The inflation-jittery bond market nearly jumped out of its skin when it saw the news on Sept. 16. Bond prices plummeted, sending the yield on the benchmark 30-year Treasury bond to 7.8%, the highest since June, 1992. To top it off, the data suggested that the economy might even be speeding up, a scenario that would fuel inflation and force the Federal Reserve to tighten policy further, maybe more than generally expected.

WHERE FACTORY OUTPUT IS SLOWING



With the third quarter is sure to be a big drag on gross domestic product. Housing has gone flat. Consumer spending is looking winded. And capital spending, while still strong, is also set to slow. That's not to mention the continuing deterioration in the U.S. trade deficit, as seen in the latest data. All this doesn't suggest a sick economy, just a slower one.

HOW MUCH CAPACITY IS STILL AVAILABLE?

The top-line output numbers in August showed that industrial production in the nation's factories, utilities, and mines rose 0.7%, with manufacturing output up 1%. From April to July, originally said to have risen 1%, is now shown to have risen 1.5%.

However, a bounceback in auto production, as Detroit speeded up assembly lines following its summer shutdown and retooling, accounted for half of the August advance in total industrial production and manufacturing output. It's not to say cars don't count. They do. But Detroit's slowdown and catchup are distorting the economy's underlying pattern.

For example, so far in the third quarter, factory production shows no sign of slowing from its second-quarter pace. But excluding motor vehicles, the remaining 94% of factory output is slowing sharply (chart). Indeed, not counting August's 11.7% surge in auto production, output of consumer goods other than autos fell 0.1% in the month, led by declines in appliances and other durable goods.

Detroit also helped to push up the industrial operating rate in August to 84.7%, and to 84.3% in manufacturing. Industry hasn't used that much of its capacity since 1989, when the rate peaked at 84.8% and scattered price pressures started to crop up. Several industries are running flat out (table).

This time, though, the accuracy of the Fed's measure is in doubt. The operating rate is the ratio of what industry is producing to what it is capable of producing.

Economists at Merrill Lynch & Co., for example, argue that the Fed is understating the amount of available capacity, which would cause the operating rate to be overstated.

During the past year, they say, the Fed's numbers show that available capacity is up 2.8%, even though equipment investment has surged 15%, suggesting a faster increase in capacity that would result in a lower utilization rate. The Fed will revise its capacity data in late November, and operating rates are likely to be redrawn at least slightly lower.

MACHINERY OUTPUT IS STILL BOOMING

Equipment investment's strength is clear in the industrial-production data. Output of business equipment rose a strong 1.6% after an equally sturdy gain of 1.3% in July. Equipment output is up 13.2% from a year ago, about twice the pace of overall industrial production.

However, the quarterly pattern of capital-spending plans indicates that the investment boom will be a bit less resounding in coming months. However, for capital-goods producers, it might not seem that way, as export demand takes up some of the slack. The problem, though, is that American businesses continue to get an increasing share of their new equipment from abroad, and that's not helping the U.S. trade deficit.

Indeed, capital goods are the Cliffs Notes of the whole

CAPACITY'S TIGHT SPOTS

INDUSTRY	OPERATING RATES AUG. '94 '88-'89 HIGH	
STEEL	95.3%	95.7%
PETROLEUM PRODUCTS	93.5	88.5
TEXTILES	92.0	92.1
LUMBER	90.3	93.3
INDUSTRIAL MACHINERY	89.8	83.7
ELECTRICAL MACHINERY	89.5	84.9
MANUFACTURING	84.3	85.1

DATA: FEDERAL RESERVE

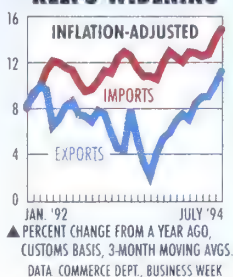
Business Outlook

foreign trade story. Overall, domestic demand has sucked in imports at a faster pace than exports have been growing (chart). The good news for the outlook is that this disparity will end.

The bad news is that the third quarter may not see the benefits. The trade deficit for all goods and services widened unexpectedly in July, rising to \$11 billion from \$9 billion in June. The dollar tanked on the bad surprise, taking the U.S. stock and bond markets with it.

The sharp erosion means foreign trade started the third quarter far below its average for the second quarter, when a deteriorating trade performance robbed almost one percentage point from GDP growth.

WHY THE TRADE GAP KEEPS WIDENING



For goods alone, the trade gap jumped to \$15.7 billion in July from \$14 billion in June. Using comparable data calculated on a customs-value basis, the merchandise trade deficit in July was the largest since 1985.

Goods exports fell 4% in July, led by a drop in aircraft. Despite this, foreign shipments are doing quite well. They've grown 10.6% in the 12 months ended in July.

One export area that is struggling is agricultural products. They're down 9.6% in the first seven months of 1994. A bad 1993 harvest, a bankrupt Russia, and greater competition from South America, China, and South Africa have eaten away at what was a major export category for the U.S.

Looking ahead, U.S. exporters will benefit from the stronger global growth expected in 1995. With Europe largely out of recession, demand for U.S.-made goods will pick up there. And the robust economies in Southeast Asia and Latin America will also power exports.

Stronger growth abroad will brighten the trade outlook for exports, while modest growth at home should slow the

tide of imports. True, imports were flat in July, but they have soared 14.8% in the past year. Slower import growth by the fourth quarter will be one of the byproducts of the Fed-engineered slowdown in domestic demand.

FEWER HOMES, FEWER APPLIANCES

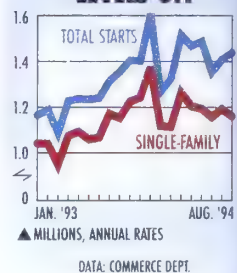
The effect of higher interest rates has already shown up in housing activity. Although housing starts rose 2.1% in August, to an annual rate of 1.44 million, all of the strength was in apartment construction. Starts of single-family homes fell 2.7%, to 1.17 million (chart). So far in the third quarter, total starts are below their second-quarter level, and they are down 3.3% from their recent peak in the fourth quarter of 1993.

Moreover, higher rates, especially for adjustable-rate mortgages, have some homeowners struggling. The Mortgage Bankers Assn. reports that second-quarter mortgage delinquencies rose for the second consecutive quarter. The uptick suggests that homeownership is becoming a burden for an increasing number of households.

With less homebuilding, demand for home-related goods will wane. The biggest losers will be appliances, carpeting, and building materials—products that go into a home as it is being constructed. Production of consumer durable goods, excluding cars, fell 0.6% in August.

With exports expected to gain steam next year and business investment in equipment likely to grow faster than the overall GDP, controlling consumer spending will remain the primary way policymakers slow down this economy. Their task is well under way: The hot data of August in the factory sector notwithstanding, the U.S. has shifted down to a much cooler pace in the second half.

HOUSING ACTIVITY LEVELS OFF



THE WEEK AHEAD

CONSUMER CONFIDENCE

Tuesday, Sept. 27, 10 a.m.

The Conference Board's index of consumer confidence probably rebounded a bit, to 90, in September, after dipping 2.5%, to 89, in August. That's the median forecast of economists surveyed by MMS International, a division of McGraw-Hill Inc. Although the confidence index has returned to its prerecession levels, consumers remain wary about job prospects.

DURABLE GOODS ORDERS

Wednesday, Sept. 28, 8:30 a.m.

New orders taken by durable-goods manufacturers likely increased by 3%

in August. That would not reverse the 4.3% plunge orders took in July. Demand for motor vehicles increased, as indicated by the gain in auto output in August. The backlog of unfilled orders probably fell again, after slipping 0.2% in July.

NEW SINGLE-FAMILY HOME SALES

Thursday, Sept. 29, 10 a.m.

New homes likely sold at an annual rate of 650,000 in August, say the MMS economists. That decline is suggested by the 2.7% drop in single-family housing starts in the month. Home sales jumped 8.3% in July, to a 664,000 pace, but higher interest rates, especially for adjustable-rate mortgages, are beginning to crimp

the housing upturn. Sales peaked in the fourth quarter of 1993.

PERSONAL INCOME

Friday, Sept. 30, 8:30 a.m.

The MMS survey forecasts that personal income rose 0.4% in August, after advancing 0.5% in July. Wages and salaries probably struggled, as indicated by the drop in weekly pay and slower job growth last month. However, higher interest rates and better corporate profits are lifting personal interest-and-dividend income. Consumer spending probably increased by a healthy 0.6% in August, after a puny 0.2% gain in July. That's suggested by the 0.8% rise in retail sales.

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HOPE AT LAST IN HAITI

AID WON'T SAVE IT. ORDER AND OPEN MARKETS WILL

Packing suitcases and cleaning up his Miami apartment, Walter Bussenius is preparing to return to Haiti. Just hours after U.S. troops began landing in his troubled Caribbean nation, he is calling customers of his essential-oils factory. He assures them that the plant, which makes oil for perfumes and has been shuttered for eight months because of the international embargo, will soon be back in business. Having fled the escalating violence in Haiti for Miami two months ago, Bussenius is anxious to return to his factory and 45-room hotel in Cap Haitien. And he's hopeful about the future. "The problems of Haiti are well known, and the opportunities are well known," he says. "All it takes is a government that will facilitate development."

If only it were that easy. Haiti's strangled economy will get a much-needed boost when the international embargo is lifted. That is a condition of the agreement by which Haiti's military leaders are to cede power to elected President Jean-Bertrand Aristide. And an expected \$550 million in international aid in the first year should provide food, health, and infrastructure.

TRADE COLLAPSE. But the daunting task of rebuilding Haiti's economic and political system is complicated by tensions between the popularly elected priest-turned-president and the uneasy business class, which fears retribution for the military's September, 1991, coup. Indeed, the ultimate success of Haiti's recovery lies in the Haitians themselves rather than in the millions in aid about to come their way. Before economic recovery can take root, Haitians say, the cycle of violence and vengeance

that has wracked the country for decades must end.

Outsiders agree. Aristide needs to create a system in which an election means "not only the victory of the majority but the protection of the minority," former President Jimmy Carter said in an Atlanta speech two days after returning from his Haiti mission.

The prospect of an Aristide return is something that many wealthy Haitians such as Olivier Nadal, one of the island's biggest importers, are slowly coming to accept. Like many of his counterparts, he distrusts Aristide but recognizes that the elected president must return for Haiti to progress. "We have so many things to do in this country," Nadal says. "We have nothing."

Even before the recent crisis, Haiti was the poorest nation in the hemisphere, with a per-capita income of just \$360 annually. That dropped below \$250 as Haiti's economy shrank by more than 15% in 1992-93, the World Bank says. The deprivation and political terrorism against Aristide supporters drove thousands of Haitians to flee the island.

Today, Haiti's economy is mind-numbingly bad. The inflation rate has soared to 46%. Trade collapsed with the embargo, decimating the country's coffee, mango, and apparel industries. Total exports fell from \$163 million in 1991 to

\$72 million in 1993. Imports tumbled to \$173 million from \$300 million during the same period.

The picture for Haiti's 7 million people is just as bleak. More than 100,000 jobs have been lost in the three years since the embargo, and 75% of the country's workforce is unemployed. Some 47% of its adult population is illiterate. In 1993, more than 20% of children suffered from malnutrition, and 1 out of every 10 babies doesn't survive the first year.



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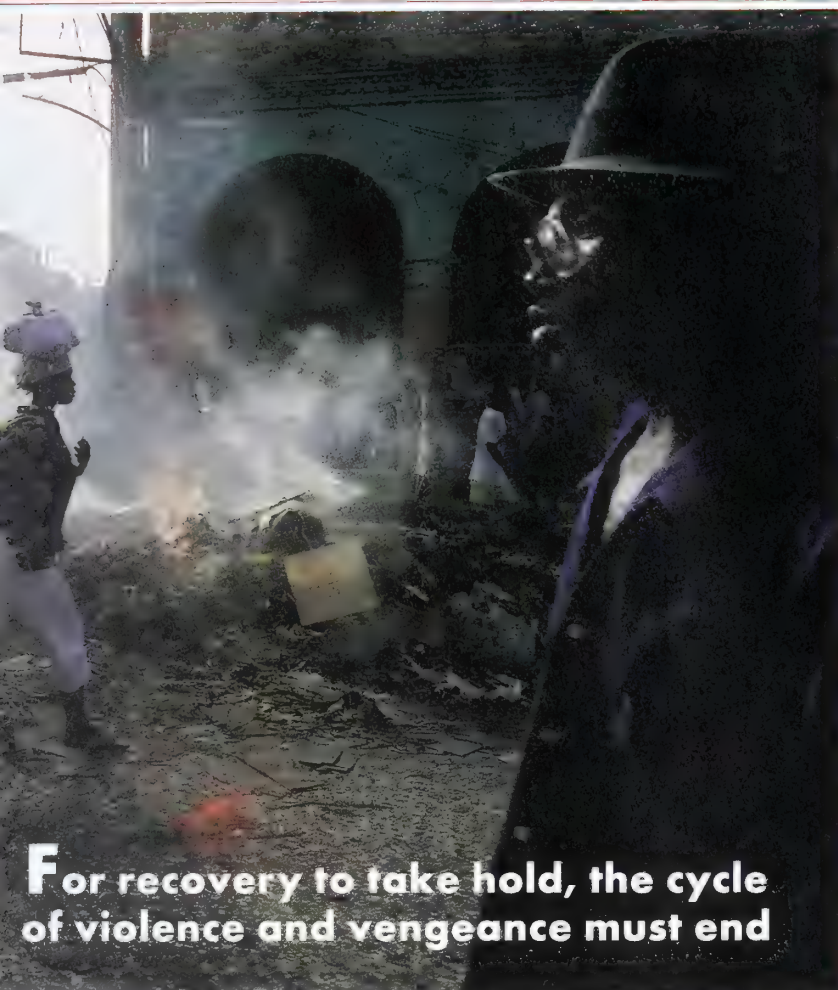
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PRICE TAG FOR STABILITY

TOTAL AID EXPECTED
IN HAITI DURING
THE NEXT 12 MONTHS
\$550 MILLION

IN MILLIONS OF DOLLARS

DATA: U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT



For recovery to take hold, the cycle of violence and vengeance must end

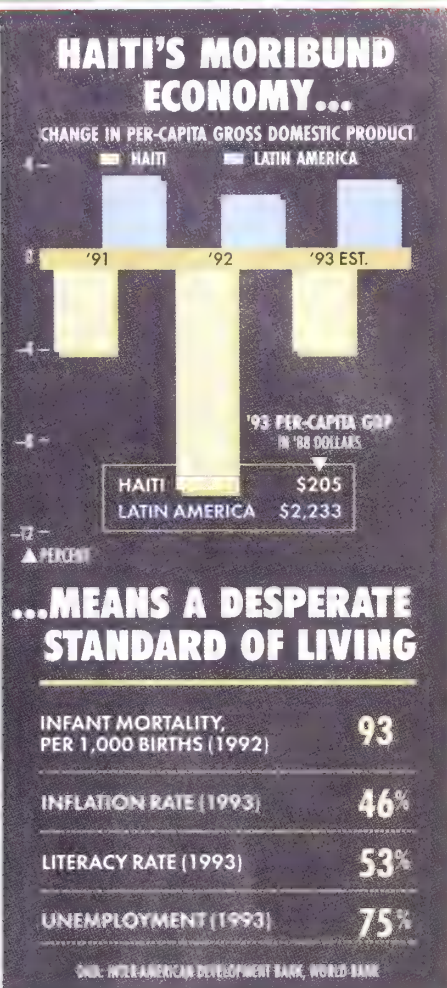
The last three years of military rule left Haiti's infrastructure battered. Electricity is provided for just six hours a day. Some 96% of the country's roads are potholed. The antiquated telephone system is near collapse. Haiti's economy is plagued by outdated equipment. Fuel-cutting for fuel has deforested all about 7% of the land while erosion and faulty agricultural practices are reducing the amount of arable land. As the U.S. officials in Port-au-Prince said earlier this year: Haiti is not on the way to becoming a better case. It is one."

The emergency assistance plan won't be a panacea for Haiti's deep-rooted problems. Half of the proposed \$550 million to be donated during the next 12 months by the U.S. and the international community will be spent in the next 90 days. An initial recovery program, crafted by a consortium of donor agencies, the World Bank, and International Monetary Fund, focuses on meeting social needs through nutrition, education and health programs, rebuilding infrastructure, and encouraging growth in the private sector. Other international

aid will come later: President Clinton promised in a Mar. 23, 1993, meeting with Aristide to help coordinate a \$1 billion, five-year international program.

Analysts say privatization of state-owned interests, including phone, electricity, water, ports, cement, and flour mills—will be critical to restructuring the Haitian economy. Breaking the monopoly that a few powerful Haitian families have on industry is also key. Aristide's advisers emphasize an open foreign-investment policy, decentralization, divestiture of state enterprises, and the need to open the Haitian economy by cutting tariffs.

SKILLED WORKERS. The job of rebuilding Haiti will be difficult—but not impossible, outsiders say. "On the positive side, [Haiti] has a skilled and hardworking labor force and entrepreneurial talent," says Rainer Steckhan, director of the World Bank's Caribbean office. One of the Haitian government's most important tasks will be to build bridges with the country's business community. "Because there is no formal way [for business] to access influential circles in the government and no rational way of



doing that, they do so informally, with bribes. Until they have a mechanism, that will continue," says Yves Savain, a Haitian American businessman.

Indeed, building government institutions, such as a justice department to balance the military's power would win over many members of Haiti's business class. "They see an urgent need to build institutions so they cannot be held hostage by civilians or by people in uniform," says Lionel Delatour, a member of the Center for Free Enterprise & Democracy in Port-au-Prince.

Anthony P. Maingot, a Florida International University professor who has studied Haiti for 25 years, was heartened by the emotional note that Aristide hit to break through the tension and distrust at the opening of a July, 1993, meeting in Miami with Haitian businesspeople. Now, as then, he says, "it is up to Aristide to strike the right chord."

Whatever the chord, the message of reform will be unpopular in some of Haiti's social sectors. Haiti's economy and society "has been based on a tremendous amount of exploitation of blacks by the mulatto class, and they've

been reluctant to give up power," says Anthony Bryan, a professor at the University of Miami's North-South Center.

Efforts to improve the lot of the poor and to expand Haiti's fledgling middle-class will mean paying fair wages, not a popular prospect for industry based on low-wage labor of \$1 a day. Marie Cerat, who helped found a nonprofit organization in Brooklyn that aids recent Haitian

immigrants, notes that an aunt in Haiti has worked in a factory for 30 years and has no insurance, no pension, and no savings. "If there is no work that day, she does not get paid," she says. "There is no potion the Americans can bring that will change anything overnight."

Nothing, indeed, is very likely to change overnight. Eventually, the establishment of political stability, a resur-

gence of trade, and a friendly climate for business investment could bring the Haitian economy back from the dead. Until then, the country can only hope that the optimism of Haitians such as Walte Bussenius is well-founded.

By Gail DeGeorge in Miami and Am Borrus in Washington, with Julie Tilsne in New York and Andrew Downie in Port-au-Prince

Commentary/by Susan B. Garland

CLINTON'S YES-NO-MAYBE-YES FOREIGN POLICY

The month of mixed signals, breast-beating, and false starts notwithstanding, it's hard to argue with President Clinton's goals in Haiti. He wanted the removal of its dictators, restoration of the democratically elected President, a halt in the refugee flow, and an end to atrocities. And despite a bipartisan pummeling over the lurching nature of the policy, he may even get what he wants.

The problem is that months of alternating bouts of bluster and retreat won't be forgotten in the afterglow of an invasion averted and despots deposed. It's only too obvious that Clinton has yet to learn that in foreign policy, there are few clear right and wrong decisions. Decisiveness and consistency are what count. So is thinking through all the repercussions of a decision.

Although the last-minute settlement that arranged the Oct. 15 resignation of General Raoul Cédras and his conspirators may win Clinton a reprieve from dropping public approval polls, the Administration's months of public hand-wringing over Haiti and other foreign policy hot spots has a price. That it took the actual takeoff of troop planes to convince Cédras & Co. that the U.S. meant business is evidence of how much Clinton has squandered his stature abroad. "We had to order the invasion to make [our threats] credible," concedes Defense Secretary William J. Perry.

CUT THE BLUSTER. Haiti is just the latest in a string of foreign policy challenges in which the Administration's flailing policy process overshadowed the eventual decision. After much flipping and flopping, the President managed to stanch the flow of Cuban refugees. But he should have heeded early warnings

of an exodus and initiated a dialogue. Then there's Bosnia. Clinton prudently concluded that U.S. intervention would fail, but only after months of threats and backtracking. In Somalia, Clinton was right to pull out when 18 American troops were killed in an ambush, but he should never have shifted the mission to nation-building in the first place. And China policy is no less messy. Clinton boasted about linking human rights to trade during the campaign and after, therefore inviting harsh criticism when he renewed Bei-

citizens while American soldiers stood by. To be sure, it may be too much to ask Clinton and his foreign policy team to come up with an overarching vision that sets guidelines for when to intervene militarily and when to stay out. But there should be some consistency of principle from issue to issue.

At the very least, the Clintonites need to quit the ad hoc policymaking and handle each new crisis more methodically. Set a realistic goal, stick to the plan, and pursue it with quiet diplomacy. Bluster and bluff don't work,

whether it's trade threats against Japan, human-rights demands to China, or nuclear confrontation with North Korea—unless Clinton follows through with action. Haiti is a clear case of Clinton beating his drums so loudly that he left himself no way out of an invasion, a policy many senior advisers privately feared was a folly.

The arena where Clinton needs to do a lot more talking is at home. A successful chief executive must first lay the groundwork for public support for controversial actions. The national dialogue that Clinton promised to hold on Haiti never happened because he worried that invasion talk would cause an uproar.

So far, Clinton has been lucky. Despite its chaotic nature, his foreign policy decision-making process hasn't produced any big disasters. Haiti may yet turn out well, too. If nothing else, Haiti has taught the President the importance of backing threats with action. In foreign policy, a President's credibility can have the firepower of the Pentagon. Maybe more.

Washington Correspondent Garland covers the President.



THE CHIEF AND FOREIGN POLICY FREELANCERS CARTER, NUNN, POWELL

jing's most-favored-nation status.

The Administration is relieved it won't need to pursue an unpopular war in Haiti. But while Clinton and his advisers crow that his resolve in the Caribbean proves he's ready for prime time, it's not clear he has established any great principles. By giving the despots he described as "murderers" and "rapists" a one-month grace period and amnesty, Clinton has chipped away at one moral cornerstone.

The questionable deal was the ultimate flip-flop. It raises questions about just how committed Clinton was. Even worse, Clinton seemed not to have examined the consequences of his deal with Haiti's generals. The President and his aides were clearly unprepared for the sight of Haitian troops killing

WHY IT'S TIME FOR A SHOWDOWN WITH JAPAN

It's high noon in trade town, and another showdown looms between the U.S. and Japan over access to Tokyo's markets. Only this one is critical. Really.

Come Sept. 30, if Japan doesn't agree to open up to American medical equipment, telecommunications, and insurance services, U.S. Trade Representative (USTR) Mickey Kantor will apply the maximum pressure: He will force Japan under the so-called "Super 301" law. Even if a modest concession is cut, Kantor may still blame Japan for barring U.S. autos, auto parts, and mass products. Kantor seized Clinton's go-ahead for the move on Sept. 20.

POWERS OF THREAT. It's a powerful tool. And the time is ripe for the U.S. to call Japan's bluff, just as President Bush did in 1989 by using Super 301 to force open Japanese markets to U.S. cellphones, plywood, and supercomputers after negotiations stalled. American officials insist they're not spoiling for a brawl. "Our approach will be fairly surgical," says one top Clinton trade adviser. "We'd rather have hope for steady, ongoing progress."

Clintonites are aware that they can't afford to rile the world financial markets, still reeling from the collapse of the U.S.-Japan "framework" talks last February. Despite the concerns, however, the 14 months of fruitless "framework" talks between the U.S. and Japan underwrite the best reason for invoking Super 301: Where all else has failed to move Tokyo, the threat of sanctions has proved effective. Faced with previous Super 301 threats, Tokyo responded by opening its market to an annual \$11 billion in U.S. exports.

Unfortunately, Super 301 has taken on an aura in Japan and around the world of being the ultimate symbol of superpower bullying. But in reality, it's not a bludgeon. No immediate retaliation is being contemplated. If Japan is cited, that would trigger a year-long investigation. At its close, the USTR would determine if there are any unreasonable practices that "discriminate

against and unduly burden" U.S. commerce in Japan. The President would then have wide discretion to take action—ranging from doing nothing to levying sanctions. "All it's really designed to do is to provide more compelling reasons to reach agreements," says Erin Endean, former director of the USTR's Japan desk.

Still, beginning the Super 301 process now is a gamble for Clinton. He likely won't get support from even the

members to agree to a framework for a Pacific free-trade pact. He contends that Super 301 threats "have managed to move almost every one of our natural allies to Japan's side."

Bergsten's observation is correct. Instead of joining the U.S. in a concerted effort to reform Japanese mercantilist trade practices, Asian nations may be distracted by fears that the U.S. will cite them next for cartel-like business practices and for trademark piracy.

Still, two recent reports show why the U.S. must not flinch. New figures reveal that foreign share of the Japanese semiconductor market—almost exclusively American—has grown from 8.6% in 1986, to 21.9%, in the second quarter of 1994. That's attributable to years of U.S. pressure and actual sanctions levied during the Reagan Administration. No wonder Japan's bureaucrats despise the 1986 semiconductor trade accord agreement and vow never again to accept similar "numerical indicators of progress," which the Clintonites are pushing.

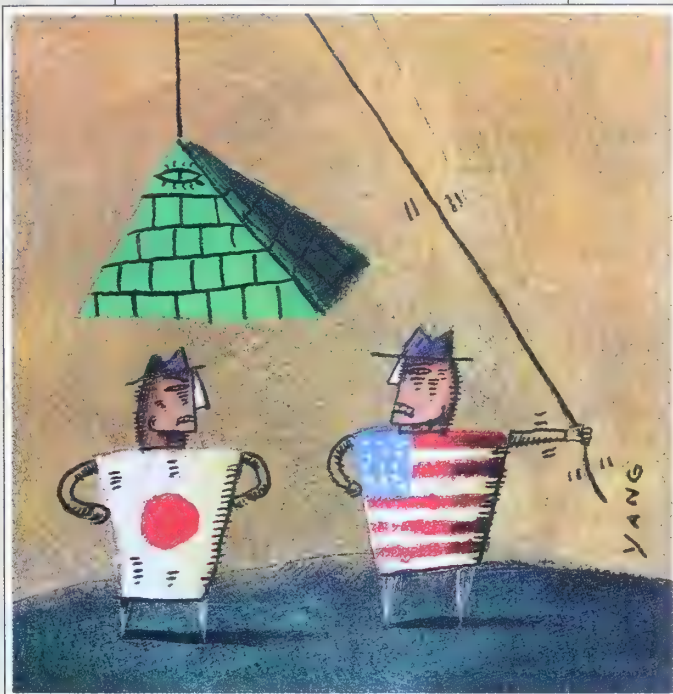
CRITICAL DEFICIT. On the other hand, the Sept. 20 Commerce Dept. report on the U.S. trade deficit demonstrates an overall U.S. failure. It shows that the gap

hit a one-month record of \$11 billion in July. Japan accounts for half of the imbalance and will run up a record \$60 billion surplus with the U.S. this year. Japanese negotiators are right to point out that the U.S. must do more to reduce its budget deficit and increase savings.

But the Clintonites, who acknowledge the criticism, must also make it clear that a chronic, growing trade imbalance between the world's two largest economies is unacceptable. Super 301 may not be the best tool, but it is a proven attention-getter.

So go ahead, Mickey, haul out Super 301 if Japan continues to balk. It's high time to show that the U.S. means business.

Harbrecht covers trade for BUSINESS WEEK from Washington.



most free-trading Republicans, who increasingly see him as a weakened opposition leader beatable in 1996. What's more, if Kantor uses Super 301 against Japan now, President Clinton will go to the annual Asian-Pacific Economic Cooperation (APEC) meeting in Indonesia in mid-November to face trade ministers petrified that they'll be next.

Among those arguing against taking such strong action is C. Fred Bergsten, the U.S. representative in charge of getting the organization's 16 mem-

"Our approach will be fairly surgical. We'd rather leave hope for steady, ongoing progress"

BEHEMOTH ON A TEAR

Coke is revving up its fortunes with a knockout marketing blitz

In the pecan-paneled boardroom of Coca-Cola Co.'s Atlanta headquarters, Chief Executive Roberto C. Goizueta dazzled his directors in late July with a fast-paced video scrapbook showcasing the past 202 days in the life of the 100-year-old company. The soft-drink behemoth had been working at a furious pace: It opened plants or reentered markets in seven nations, including India, Poland, Russia, South Africa, and Vietnam. It rolled out two new soft-drink lines, debuted a racy diet Coke campaign, and revived the trademark curvy Coke bottle, modernized in plastic.

The payoff came on Sept. 19, when the Coke marketing machine announced eye-popping third-quarter worldwide volume increases of 12%. Coke's stock jumped 1½ points, to \$49, on the news, though it has since dropped back a tad. Kidder, Peabody & Co. figures earnings in the third quarter will jump 26% vs. a year ago, to \$730 million on sales of \$4.2 billion. "What we are witnessing the world over is the consumer reconnecting himself and herself with Coca-Cola," says Goizueta.

PERSONAL QUEST. Goizueta has reason to crow. After years of marginal market share growth, languid product development, and stodgy marketing, Coca-Cola is revving up its fortunes. It's tweaking every aspect of global marketing, adding cutting-edge advertising, new packaging, product sampling, and high-profile sponsorships. It's also pushing new products out the door faster than ever before.

The rejuvenation of Coke has become a personal quest for Goizueta. Until April, the veteran executive was a candidate for retirement upon his 65th birthday in 1996. Celebrating his 40th anniversary with the company this year, Goizueta could easily have stepped aside.

Despite his failure to establish the New Coke brand in 1985, he has dazzled Wall Street in the past five years with 18% average annual hikes in earnings. Thanks largely to him, Coca-Cola's market cap now stands at \$63 billion.

Still, Goizueta knew Coke needed a radical tune-up. In recent years, Coca-Cola Classic, the nation's top cola brand, couldn't budge its market share above 20%, even as alternative beverages swallowed a full 12%. Worse, the U.S. cola market has shrunk from 63.6% of soft-drink sales in 1984 to 58.8% at year-end 1993, according to *Beverage Digest*—a loss of \$2.4 billion in potential retail sales. The company's overseas volume was growing at only 6%; Coca-Cola had not reached its average annual

growth target of 8% for three years.

Worse, Coke went nearly a decade without a new product in the U.S. while new-age rivals such as Snapple claimed \$5.9 billion of the \$49.1 billion U.S. beverage market last year. "The problem was that diet Coke was driving the engine and everybody was living on that," says one former executive. Agree Goizueta: "We could have been quicker" in responding to challengers.

Wall Street has penalized Coke for its lethargy. Even as share buybacks, price hikes, and production efficiencies beefed up Coke's yearly operating earnings per share by 39% in the past two fiscal years combined, its stock budge only 11% in the period.

Now, Coke is charging back with new brands such as OK Soda, Fruitopia, and the sport drink PowerAde. The goal: to persuade retailers that Coke can be a one-stop shop for soft drinks—a company that can fill the shelves with a varied family of products backed by unmatched advertising and marketing. And it's coming out with new services rivals will be hard-pressed to match. For instance, Coke now analyzes a store's profitability on each beverage, its returns on its shelf-space allocations, and the sales impact of local demographics.

Behind the new offensive is M. Doug

Global splash: The soft-drink producer has rolled out The Real Thing in Hanoi as well as other new markets



Ivester, Coke's new president and operating officer. Ivester took on challenge 18 months ago, when Goizueta assigned him to rejuvenate brand. His key job, Ivester says, is to get through product clutter by redefining what makes Coke "special, different, and better." Coke also needed a cultural transformation to shake loose stodgy past. "We had to sort of zero-out our thinking," Ivester says.

Ivester made two moves. First, he moved Madison Avenue giving Hollywood's Creative Art Agency (CAA) a clean slate to revitalize the soft drink's marketing. Then, he hired Sergio Zyman, who had left the company under a cloud after spearheading the New Coke reformulation.

KNOWN PACKAGE. CAA shattered its longtime, "one sight, one sound, one agency" approach with its "Always Coca-Cola" campaign featuring images of the brand as Coke-chugging polar bears and rockers. "They took the creative cuffs off," says CAA Chairman Mitchell Ovitz.

The ads are more than just glitz. CAA

calculatedly jam-packs its messages with the brand's traditional symbols: the trademark red disk, the contour bottle, the classic Coca-Cola script—reinforcing to consumers the symbols that say Coke.

Anointing Zyman as Coke's new chief of marketing was equally shocking. He's far from a traditional Coke man. The hard-charging Zyman clashed with a culture he has called "frustrating and ex-



What we are witnessing the world over is the consumer reconnecting himself and herself with Coca-Cola"

ROBERTO C. GOIZUETA
Chairman & CEO

remely tiring." Today, when managers stubbornly embody the closed-minded old Coke, Zyman makes them wear a shirt bearing the words, "I'm not the target audience."

Now, the public is starting to get a taste of the Ivester-Zyman chemistry in moves such as their resurrection of Coke's contour bottle. Coke surveys showed the contour is the world's best-

known package. And consumers polled in test markets preferred it 5-to-1 over the generic plastic bottle. "Contour is a brand in and of itself," asserts Ivester.

Rival William C. Cobb, vice-president of marketing at Pepsi-Cola Co., says it's more like an irrelevant antique. "They're kinda resuscitating an old bottle and claiming that as an innovation," says Cobb. "But that was an innovation 80 years ago." Cobb counts Pepsi's new 24-pack, "The Cube," and its freshness-dating of Diet Pepsi as real innovations that have pushed up its supermarket sales by 8.2% over the last year.

Still, the impact of Coke's contour, rolled out in March, has been impressive.

In Chicago, contour sales pushed up Coke Classic's sales in supermarkets and other stores by more than 62% through July. Overall, Coke brass estimate the bottle has increased Coke Classic's volume in markets where it's available by 25% to 75% in the same period.

Ivester also revived another Coke chestnut: consumer sampling. Under Ivester, this grassroots tactic goes gonzo.

For example, on June 18, Coke gave thousands of gallons of free product to German consumers. With the help of such moves, Coke's European case sales were up 14% to 16% in the third quarter, Goizueta says.

Coke's product development labs are humming, too. Within the past year, the

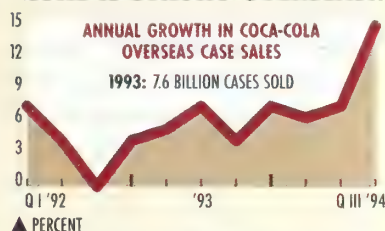
beverage giant has turned out a new product in each of three key markets. Its Fruitopia line of fruit-based drinks is angling for the alternative-beverage drinker with flavors such as Citrus Consciousness, Strawberry Passion Awareness, and Cranberry Lemonade Vision. Positioned as the hip, new sports elixir, Coke's PowerAde is challenging Gatorade's 79.5% share of that segment.

"TRULY DANGEROUS." Generation X-inspired OK Soda, with its stark silver can adorned with black-and-white graphics, shows just how far Coke's marketing approach has evolved. The lightly carbonated soda was rolled out in tests in May. As part of the introduction, thousands of high school students received quirky letters promoting "OK-ness." On the can, drinkers are invited to dial 1-800-I-FEEL-OK to relate their OK stories. So far, the company has logged 13 million calls, and OK is snagging up to 5% of Coke's volume where it's available, the company reports. "Coke is becoming truly dangerous because they are now taking risks," observes Tom Pirko, president of New York consultants Bevmark Inc.

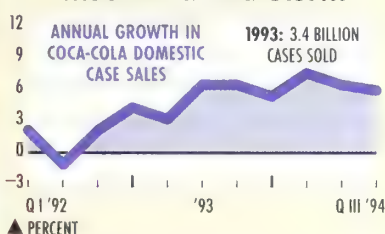
Billionaire investor Warren E. Buffett, for one, really likes what he sees. In August, Buffett pushed his stake to more than 100 million shares—the largest of any shareholder. Buffett believes that Wall Street has overlooked a big improvement in the way Coca-Cola is pushing its product line. "I don't pay any attention to what the stock does," he explains. "If the business does well, the stock eventually follows." If Buffett is right, Goizueta, the ultimate Coke man, just may retire one day to the sound of champagne corks popping.

By Maria Mallory in Atlanta

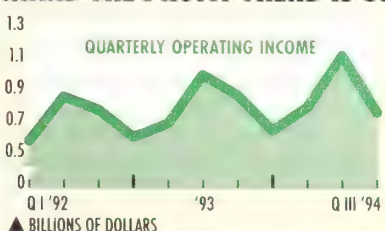
COKE IS STRONG OVERSEAS...



...SOLID IN THE U.S....



...AND THE PROFIT TREND IS UP



DATA: COMPANY REPORTS; KIDDER, PEABODY & CO.

FOOTBALL

RUPERT RUNS FOR DAYLIGHT

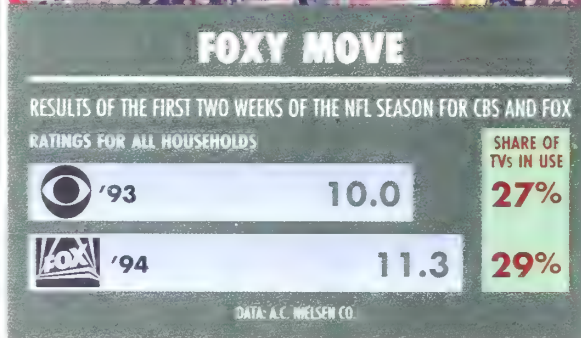
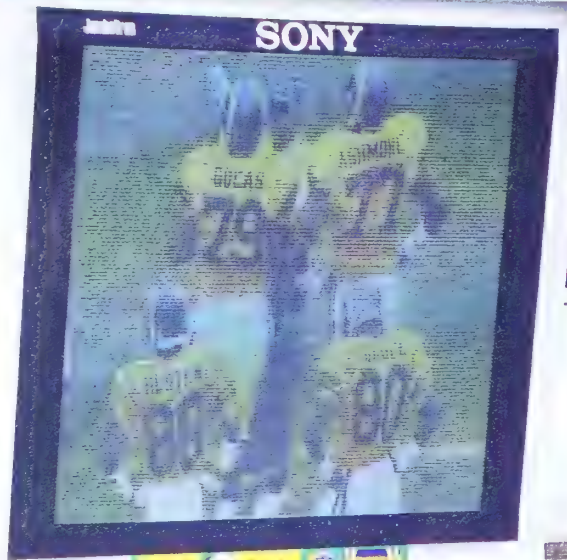
Baseball's collapse makes Fox's football coup look very sweet

Like a well-trained athlete, News Corp. Chairman Rupert Murdoch knows it helps to be lucky, too. Take his Fox Inc.'s month-old TV broadcast of professional football—secured at the dangerously high price of \$1.6 billion for four years and all but guaranteed to produce losses well past Super Bowl Sunday. That was before the collective minds that control Major League Baseball decided on a protracted strike just as America's pigskin heroes were taking to the field.

Now a month into the current season, Fox is starting to look like the Green Bay Packers of old. Ratings for the first two weekends were up by 13% over a similar period last year, when the games were broadcast by CBS Inc. And true to Fox's tradition, ratings were especially strong for those under age 34. Better yet, with the Sept. 14 decision by baseball owners to cancel the rest of the season, Fox won't be competing with pennant races, playoffs, or the World Series.

SUNDAY VACUUM. "No one in San Francisco is flipping any coins between watching the '49ers or Matt Williams," says media buyer Paul Schulman, president of Paul Schulman Co. Advertising agencies once predicted Fox would fall 5% to 7% behind CBS last year—or roughly 600,000 viewers—says Ralph Heim, manager of media placement at Coors Brewing Co. But that was before baseball scoreboards in Chicago, Los Angeles, and New York went dark. "Now, there's a vacuum for the sports fan on a Sunday afternoon," says Heim, a heavy advertiser on Fox.

Early numbers for NBC Inc., which carries the American Football Conference games, also are up. But even before Bud Selig and the other baseball moguls fumbled away their share of TV riches to football, Fox had launched a massive promotional blitz on its own network shows to lure channel switchers. Football star-turned-commentator Howie Long showed up on *Beverly Hills 90210*, while *The Simpsons* gathered around to watch the Sunday NFL game on Fox. (Homer Simpson on football: "It takes the unpleasant aftertaste of church out of your mouth.")



In all, Fox spent more than \$30 million to launch football—including billboards and movie trailers featuring announcer John Madden. It also didn't hurt that Fox has had interesting games so far, including the first matchup of superstar quarterback Joe Montana and his Kansas City Chiefs with his former San Francisco '49er teammates. Coming up: a major cross-promotion with McDonald's Corp. featuring 400 free Super Bowl tickets.

Still, at the outset, Fox had hoped simply to match CBS's ratings from last year. Even at that, Murdoch said, he saw losses of at least \$100 million the first year. Now, his executives say that estimate will likely be slashed. The network is already peddling the 25% of spots it had held back as compensation

FOOTBALL HAS HIKE FOX'S PROJECTIONS FOR AD REVENUES BY \$50 MILLION

to advertisers if it failed to meet its viewership guarantees. Those 30-second spots may sell for as much as 35% above the average \$110,000 Fox charged earlier in the season, says Jon Nesvig, president of Fox's sales unit. Playoff spots could fetch \$200,000 or more.

Fox is also wrangling to get some of the \$130 million in ad sales that have been sold for the now-cancelled playoffs and World Series by the Baseball Network, a consortium of ABC, NBC, and Major League Baseball. Among the sponsors were General Motors, Texaco, MCI Communications, and Avis.

STRONG LURE. Football's better-than-expected numbers, coupled with a suddenly tighter market for TV ads, prompted Fox to increase to \$300 million its initial \$250 million projection for ad sales, according to one source familiar with the network. And those numbers don't count the estimated \$75 million in additional advertising sales that Fox will generate this year from upgrading its station lineup. With pro football as a powerful lure, Fox has replaced lower-powered UHF stations with VHF stations in such football hotbeds

as Cleveland and Kansas City, and will soon upgrade from its Dallas station's UHF as well. That will help Fox increase its coverage to 98% of the country from 92%.

Of course, a lot can still happen to keep Fox from television's end zone. What if Dallas' golden-boy quarterback Troy Aikman, breaks a leg, or the New York Giants suddenly fold? And cheer out the fourth weekend of the season when popular teams such as the Cowboys, New York Giants, and Philadelphia Eagles all have the day off. That leaves Fox to cover such weak sisters as New Orleans, Tampa Bay, and Atlanta. Bad games don't make healthy ratings. But for now at least, the ball is sailing Murdoch's way.

By Ronald Grover in Los Angeles



WALKING OVER: UAW STRIKERS HECKLE SOME OF THE 4,000 WORKERS WHO HAVE GONE BACK ON THE JOB

FOR NOW, THE UAW CAN'T KEEP CAT FROM PURRING

Union's three-month strike has yet to stop productions or profits

About 150 strikers are on the picket line one recent morning outside Caterpillar Inc.'s Aurora manufacturing facility. Mainly mid-aged men, they whistle and yell at cars and buses carrying temporary replacement workers through the streets. But many worry that their battle with the construction equipment giant has been overshadowed by the baseball strike. Says one picketer: "Heck, it's all talk about out here ourselves."

Call it the forgotten strike. Across the country, 10,500 Caterpillar employees continue to hoist picket signs, while 40 of their brethren have returned to work. The dispute over management's firing of union members, which many expected to end shortly after its late summer start, now looks likely to last. The United Auto Workers strengthened its members' resolve by tripling monthly strike pay to \$1,200 in early August. But Cat has kept most of its factories humming with a ragtag band of UAW journeymen and office workers, along with temporary and permanent new employees. Says University of California at Berkeley labor economist Harley Shaiken, "This strike has entered a long-term stalemate."

GAME OF CHICKEN. But how long can the stale sides hold out? "One day longer at Caterpillar," vows UAW Local 145 President John Paul Yarbrough. Indeed, any striking workers, living in smaller cities and semirural areas, can easily

pay their bills with their increased strike pay. And the union's \$1 billion strike fund means it can keep paying benefits almost indefinitely, if it chooses. UAW officials expect inventories to run out in the fourth quarter, shellacking Caterpillar's bottom line.

Not so, says Caterpillar. Although the company admits few workers have crossed the picket line in recent weeks, it hopes for a flood of defectors after it announces third-quarter results in early October—the first financials that will reflect the impact of the strike. Smith Barney Shearson Inc. analyst Tobias M. Levkovich predicts the company will earn \$148 million, up 12% from last year, on sales of \$2.9 billion (chart). He thinks Cat could hold out for at least six to nine more months before the strike begins to pinch.

Certainly, Caterpillar looks to be holding its own so far. When the strike started on June 21, the company immediately shifted 6,000 office workers—many of whom had gained factory experience in a 1992 strike—into its plants. Cat initially concentrated on cranking up production at its components facilities such as its heavy-duty engine plant in Moline, Ill. Now it says parts production is

workforce has returned, "it's going as well as Caterpillar says it is," says one employee. Caterpillar officials predict all plants will be producing at 100% of pre-strike levels by Oct. 1.

That might be a stretch. The company still faces big difficulties at its mining equipment facility in Decatur, Ill., where less than 10% of workers crossed the picket line, and at its York (Pa.) parts operation, where only 15% have gone back to work. But Caterpillar is hiring temporary help and in some cases has borrowed skilled workers from its dealers.

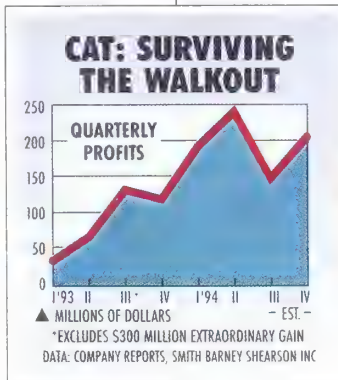
WALKING A TIGHTROPE. So far, dealers and customers haven't seen major problems. James L. Hebe, president of truck manufacturer Freightliner Corp., says there haven't been any delays in Cat engine deliveries—or any falloff in quality. And one large dealer says he hasn't had any delays either, though he feels quality has suffered since the strike.

Nobody thinks Caterpillar can keep this makeshift system going forever. The company has had to shift workers from key areas like

new product development to the assembly line. "You can't do that too long, or product will get stale," admits one line-cropper.

But neither Cat nor the union seems likely to cave in anytime soon. And Cat's hiring of temps "only adds to the bitterness," says Shaiken. As this strike drags on, the jeers and jibes at Cat's plant gates are going to get ever more pointed.

By Kevin Kelly in Aurora, Ill.



CAN WESTINGHOUSE DODGE A NUCLEAR KNOCKDOWN PUNCH?

A suit by Duquesne Light could batter its reputation—and balance sheet

From the sound of the testimony in Pittsburgh Federal Court, you would think Ralph Nader was raking the nuclear-power industry over the fuel rods. Witnesses charge a manufacturer with selling dozens of nuclear plants with leaky pipes and later conspiring to cover it up. Attorneys tell of utilities running shoddy operations, pouring caustic chemicals "like oven cleaner" into supposedly pristine water systems. Damaging charges for an industry in desperate need of good public relations—and they all come from two charter members of America's nuclear fraternity, Westinghouse Electric Corp. and Duquesne Light Co.

The two Pittsburgh companies, which teamed up to build and operate America's first commercial nuclear plant in 1957, are duking it out before a hometown jury. Duquesne, leading a partnership of five utilities, is seeking \$350 million from Westinghouse for selling allegedly defective steam generators in the '60s, '70s, and '80s. Racketeering charges could triple the damages. Westinghouse, which faces four similar lawsuits across the country, is fighting back by charging that Duquesne botched the piping in the Beaver Valley Nuclear Power Plant outside Pittsburgh. "It's not good for either company," admits Thomas M. Anderson, Westinghouse's director of settlement management.

HOT WATER. Westinghouse, just recovering from the \$5 billion meltdown of its financial subsidiary, has more to lose. Unlike General Electric Co., which has settled a host of similar suits over the past decade—including one last February with Duquesne and its partners—Westinghouse is fighting with a depleted war chest. A judgment of up to \$1 billion and a series of me-too suits could plunge it back into deep trouble. Already, it is wrangling in court with 150 insurance

companies over possible liability claims.

The source of the dispute: When Westinghouse built the first Beaver Valley plant in the late '60s, it used a new commercial technology called pressurized water. Radioactive water flowed past the fuel rods and, scalding hot, up through narrow tubes of the mammoth steam generators. This heated other water outside the tubes, creating steam to turn electric turbines. A small version of this system worked well on Navy ships. But by the early '70s, Westinghouse was seeing that the longer tubes in commer-

MUDSLINGING IN BEAVER VALLEY

DUQUESNE SAYS

Defects in Westinghouse's generators cause cracking and corroding, and the company has concealed the problems for 25 years.

WESTINGHOUSE SAYS

Duquesne's shoddy operations, including the pouring of caustic chemicals into the supposedly pristine water of its reactors, led to corrosion.

DATA. COURT DOCUMENTS



that service experience is good?

Westinghouse's attorneys argue that such snippets from company memos are taken out of context. In the "crumbling" quote, for example, they say engineers were plotting ways to get more research funds from Westinghouse, not to fool customers. This defense worked before: Westinghouse won a 1991 suit brought by a Brazilian utility. But that case was decided by an International Chamber of Commerce panel in Switzerland.

BAD CHEMISTRY. Facing an American jury, Westinghouse's lawyers are reaching up their defense. First, they argue that Duquesne Light and its four partners—Ohio Edison, Cleveland Electric, Toledo Edison, and Pennsylvania Power—were sophisticated enough to understand the risks of metal corrosion. More explosively, they charge that Duquesne, the operator of the Beaver facility, failed to ensure proper water chem-

ical plants were cracking and corroding. By the late '80s, many of its customers, including the owners of the two Beaver Valley units, faced overhauling or replacing the generators. Duquesne says it has had to order three new generators, worth \$120 million, and that it may need three more.

Beaver Valley's warranty expired back in the '70s, but Duquesne and its partners charge that Westinghouse knew about the corroding tubing and hid it from its customers. "The key," says Duquesne CEO Wesley W. von Schack, "is what Westinghouse knew, when they knew it, and what they told the industry." The plaintiff's brief cites a 1968 memo from a senior Westinghouse engineer, stating: "What do we tell them at this stage? That the alloy is crumbling in front of our eyes or

AT DUQUESNE LIGHT: DID WESTINGHOUSE CONCEAL DESIGN FLAWS? istry. The problems in the tubes were caused by tainted water, they say, the result of periodic misuses and haphazard plant chemistry control.

Westinghouse can only hope the jury agrees. With a new modular nuclear plant coming out in a few years, it is betting much of its future on the \$1 billion nuclear division. But first, it must survive the suits. With five settled, five remain. And if it loses, more suits could come. Facing that scenario, the company has little choice but to disparage its customers in court. The question now: Will the utilities—and the public—forget all the ugliness when Westinghouse comes knocking with its new reactors?

By Stephen Baker in Pittsburgh

Revolutionizing an industry happens once in a lifetime. Okay, maybe twice.



When the world asked for color, Canon responded with the revolutionary Color Laser Copier. Now Canon is answering today's color needs with a visionary new generation of color solutions, the Canon Color Laser Copier 800 and 700.

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WHEN LESS IS MORE IN CORONARY CARE

New research says many procedures are unnecessary or even harmful

As America's No. 1 killer, heart attacks have been a top target of the nation's high-tech medical arsenal. Threading tiny catheters into blood vessels around a stricken heart, cardiologists can pinpoint blockages in an artery and dislodge the clots, or bypass them entirely by grafting veins. Costly yet commonplace, heart surgery symbolizes the heroic treatments that make U.S. medicine the envy of the world.

It may also symbolize something else for which the nation's health system is famous: waste. A groundbreaking new study from the Harvard Medical School concludes that 25% of the invasive procedures performed on elderly heart-attack victims—catheterizations, balloon angioplasties, and coronary bypasses—could be eliminated with no effect on patients' survival. The best way to reduce heart-attack deaths, researchers say, would be to transfer the \$600 million wasted on unnecessary procedures to better care within the first 24 hours after an attack. Such treatments range from clot-busting drugs to better emergency response and CPR training.

The new study, published in the Sept. 21 *Journal of the American Medical Assn.*, adds to a raging debate over how much of Ameri-

ca's \$900 billion health-care tab is squandered on inappropriate care. Researchers have documented overuse of dozens of procedures, from angioplasties to hysterectomies (table). More surgery often doesn't extend life: The Harvard team found that elderly heart-attack victims had lower mortality rates in New York, where 15% were catheterized, than in California and Texas, where 27% underwent the procedure. Such research shows that "we could cut medical costs by one-third in this country without any measurable effects on quality," says David M. Eddy, a Duke University physician and health economist.

Drawing on such studies, the Clinton Administration claimed its reform plan could expand coverage and brake the rise in health spending. Given the demise of President Clinton's universal-care bill, that claim won't soon be tested—but pri-

vate insurers and health-maintenance organizations are pushing hard to realize similar savings. Their efforts are supporting a growing industry of "outcome research" aimed at codifying the tests and practices that produce the best results for patients at the lowest cost. "It's time for medicine to figure out the value of treatment, instead of just what we charge for it," says David B. Nash, medical editor at the new *Journal of Outcomes Management*.

The Harvard researchers tracked 205,021 Medicare patients, 65 years and older, who suffered a first heart attack in 1987. The results depended on how far patients lived from a hospital with extensive cardiac facilities. They found that the "close" patients were 34% more likely to be catheterized and 25% more likely to get bypass operations. But over the next four years, the two groups' death rates didn't vary significantly, except in the first 24 hours after the heart attack: In that time, 7.5% of the patients who lived near a cardiac hospital died, vs. 8.9% of the other group. The difference was attributed to cardiac hospitals' greater experience, not to high-tech procedures.

The study's drawback: It doesn't tell doctors how to identify the one candidate in four who shouldn't undergo surgery. But cardiologists "know which patients are on the line—they can adjust," says co-author Mark McClellan. "If you've got \$100,000 to spend, think hard about investing it in intensive response rather than a new cath lab."

PATIENTS INSIST. Skeptics contend such changes won't have much impact on medical costs. Tallying up all the feasible gains between now and the year 2000, economist Daniel N. Mendelson of consultants Lewin-VHI Inc. estimates that health spending would still grow five percentage points faster than inflation. "Identifying unnecessary procedures is one thing; eliminating them is another," Mendelson says. "If Mrs. Smith believes a bypass will relieve her pain, she's going to find a way to get it."

So far, the Mr. and Mrs. Smiths of America are getting what they want. From 1987 to 1990, catheterization rates among the elderly increased 42%, bypass rates rose 41%, and balloon angioplasty use doubled. But with the spread of managed care, medicine's focus is shifting. Advocates insist that eliminating wasteful care will actually boost quality. But judging from America's demand for high-tech miracles, the public remains to be convinced that medicine and economics are a healthy mix.

By Mike McNamee in Washington

HOLD THAT KNIFE?

Share of medical procedures of doubtful value

CORONARY ARTERY BYPASS	up to 44%*
CORONARY ANGIOPLASTY	42%
HYSTERECTOMY	41%
CORONARY ANGIOGRAPHY	24% to 26%*

*Range of findings from multiple postoperative studies

DATA: RAND CORP.

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EDITED BY THANE PETERSON

GETTING UP TO SPEED WITH ORACLE

Anyone looking for an on ramp? On Sept. 26, software maker Oracle plans to announce new programs designed to move corporations onto the Information Highway. Oracle TextServer is a database system that can organize, store, and retrieve the millions of documents that companies generate each year. The new system, together with a new document-sharing program and existing database and video-server products, will let corporations circulate any data over networks—from purchase orders to training videos. Oracle hopes that its software—and

its partnerships with telephone companies, book publishers, and others—will put it ahead of Microsoft in the race to create the much-ballyhooed I-way.

IN BOSTON, A FLURRY OF PINK SLIPS

New England's big banks have been copying each other for years. They lost money together during the banking crisis five years ago, and now they're making similar cost-cutting moves. On Sept. 19, Shawmut National eliminated the jobs of Vice-Chairman Allen W. Sanborn and two other top executives, citing the need to increase efficiency at the top. Last October, Bank of Boston Chairman Ira Stepanian axed three of his top lieutenants, saying he needed greater efficiency at the top. Stepanian followed his cuts with layoffs: Now, Shawmut Chairman Joel Alvord plans to cut 600 jobs. But Alvord is different in at least one respect: Stepanian got rid of his bank's helicopter. Alvord has kept Shawmut's corporate plane.

WHO'S AFRAID OF DOWNTOWN MALLS?

Are decaying inner cities a good investment? Ten of the country's top banks and insurers are betting yes. On Sept. 22, they were set to announce the creation of a novel \$24 million equity fund to finance shopping centers—anchored by such big-league supermarkets as Pathmark and Safeway—in 12 to 14 inner cities nationwide. Put together by Local Initiatives Support, a New York group that funnels private-sector money to nonprofit community-based developers, the new initiative expects to generate an annual pretax return of at least 10% for investors that include such heavyweights as J.P. Morgan, GE Capital Services, and Bank-

HEADLINER

IS A NEW CEO ON KMART'S SHOPPING LIST?

Kmart is looking for a new senior executive. The question outsiders are asking: How senior?

Headhunters report that the troubled retailer is actively searching for a chief operating officer who would serve under Chairman and Chief Executive Joseph E. Antonini. But some outsiders believe that the board actually is looking for a new CEO to replace Antonini. One headhunter noted that the COO search could be a smoke-screen—a way to avoid asking Antonini to allocate funds to find his own replacement.

Antonini has been under intense pressure from share-

holders who want him to forge a turnaround for Kmart. And retailing consultants say Antonini could use a strong No. 2 to do the job. A Kmart spokeswoman won't detail the company's hiring plans, but she points out that at last spring's annual meeting, Antonini promised a complete review of Kmart's management.

Outside sources confirm that a board committee has been looking for new senior managers.

Antonini, who couldn't be reached to discuss the executive search, told BUSINESS WEEK in mid-August: "I feel secure in the job."

By James B. Treec



CLOSING BELL

ALUMINUM HIGH



A year ago, aluminum companies were nearly buried under cheap Russian metal. But six months ago, major producing nations reached a global accord to cut production. Now, the London Metal Exchange's inventory is shrinking, and aluminum prices are rocketing. Industry leader Alcoa's share price soared to a 52-week high of 86½ in mid-September. Rivals such as Alcan and Reynolds Metals are also recording big gains. But can the accord hold? With lots of unused capacity around, producers will be tempted to bring plants back onstream, jeopardizing their recovery.

DATA: BLOOMBERG FINANCIAL MARKETS

ers Trust. Similar projects in Brooklyn, Newark, and Washington are thriving.

EUROPE GIVES LOTUS THE JITTERS

Will Europe sink Lotus Development's third quarter? Investors fear the worst after Lotus warned of tough markets in Britain, France, and Spain. From Sept. 15-21, its shares tumbled 9.7%, to 39½, as analysts noted its sales woes in the face of a strong European personal-computer market. Dean Witter analyst Timothy McCollum believes that Lotus' expected September rebound in Europe failed to materialize. He slashed his earnings estimate by 10¢ a share, to 28¢.

LONG JOHN SILVER AT ARBY'S TABLE

It's the ultimate surf-and-turf deal. On Sept. 21, Tri-

quire Long John Silver's restaurant for about \$525 million. Triarc will merge the fish-and-seafood chain with its Arby's roast-beef-sandwich operation. Triarc says the combined companies will have 4,200 outlets, which will generate more than \$2.5 billion in annual sales. The two chains now plan to offer items from each other's menus. Triarc acquired Arby's as part of its purchase of the former DWG, which had been controlled by Miami Beach financier Victor Posner.

ET CETERA...

- ▶ Three top executives at Micron Technology quit, citing personal reasons.
- ▶ Myron E. Ullman III, Macy's CEO, quit. Headhunters doubt he'll go to Kmart (box).
- ▶ Prozac sales "stronger than expected" are driving up earnings at Eli Lilly.
- ▶ National Medical Enterprises is negotiating a merger with two huge hospital groups.



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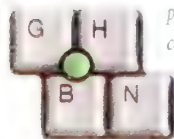
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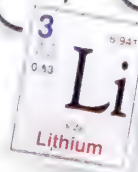
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MARION BARRY MAY BE MORE THAN JUST AN EMBARRASSMENT

Washington's once and future mayor, Marion Barry Jr., has blunt advice for the nervous nabobs of the Democratic Establishment who fear that a convicted crack user is the wrong leader for the capital: "Get over it." Likely, Barry's backers may see his Sept. 13 Democratic primary upset as a populist declaration of independence from the city's affluent white minority. But it has troubling portents for national Democrats: Barry's resurrection reinforces the notion that Washington is the capital of corruption. Worse, the lack of party support for Barry further inflame black Democrats disoriented by Bill Clinton's drift to the center. That certainly won't curb the falloff in voter turnout that's hurting Democratic prospects in the fall elections.

Many voters outside the Beltway—already frustrated with capital goings-on—can't fathom Barry, who served six months in prison on a drug conviction, now has a virtual lock on the general election. "It makes Washington look totally out of touch with the rest of the country," says William Kristol, chairman of the Project for the Republican Future.

POSITIVE IMAGE. Barry's comeback plays directly into the hands of chief House GOP campaign strategist Newt Gingrich (R-Ga.), who will become House Republican leader next year. Gingrich is portraying Democrats as venal and corrupt. Now he can add Barry to his list of indicted Democrats: Ways & Means Committee Chairman Dan Rostenkowski and two Congressional Black Caucus members, Walter R. Brown III (Calif.) and Mel Reynolds (Ill.). "It all enhances the positive image of the Democratic Party," says a GOP leader.

Democrats say it's silly to think that Barry-bashing could elect a Republican in, say, Dubuque any more than Virginia's GOP Senate hopeful, Oliver L. North—whose Iran-Con-

tra conviction was overturned on appeal—will benefit Democrats in other states. "Americans don't believe that the average Democrat is a convicted crack user," scoffs Democratic pollster Mark Mellman.

But Barry gives Clinton headaches. When reporters asked Al Gore if he backs Barry, the Veep hemmed and hawed: "Not being a voter in the District of Columbia, I don't think it's up to me to question their decision." Yet the candidate who inhaled won't take the hint. Barry has asked Clinton to campaign with him. The White House demurred: "Scheduling conflicts."

That's not the only conflict Barry faces with the feds. D.C.'s congressional overseers—more concerned about the city's unbalanced budget than their own—have told the locals to pare \$140 million in spending. Now, they fear a return of the man whose profligacy created the nation's most bloated city bureaucracy. "If he tries to fatten up the payroll, he's going to have a war on his hands," warns Representative James T. Walsh (R-N.Y.), top Republican on the D.C. Appropriations panel. Congress would then chip away faster at the District's limited home-rule powers.

That would further antagonize the city's black majority, with spillover to Democrats' most loyal constituency nationwide. Angry African Americans believe black politicians are being singled out—most recently, Agriculture Secretary Mike Espy, who is under attack for financial improprieties. With black turnout in this year's primaries the lowest since the civil-rights struggles of the '60s, stay-at-homes could mean Democratic defeats in several close races. "It could have mind-boggling consequences," frets a Democratic consultant.

With Republicans set to use any weapon they can, Barry is ammunition. Democrats can only hope voters get over it.

By Richard S. Dunham



D.C.'S NEXT MAYOR?

HEALTH CARE

The White House and Congress are all but pulling the plug on health-care reform this year. But pro-reform activists are regrouping. Unions, seniors, and consumer advocates will mount a new push next year. But Capitol Hill leaders wonder if they can rally members so soon after this year's failure. A few are still trying to resuscitate reform: Senators Bob Graham (D-Fla.) and Mark O. Hatfield (R-Ore.) are unveiling yet another compromise to make insurance easier to buy and give states more freedom to design health-financing plans. Senate leader George J. Mitchell (D-Me.), also

is trying CPR, but most colleagues say only a miracle will revive this patient.

THE ADMINISTRATION

The Energy Dept. is jealous that Commerce Secretary Ronald H. Brown is hogging so much media attention as the Administration's top rainmaker for U.S. business. So, not to be outdone by Brown's recent high-profile trip to China, Energy officials are going all out to publicize a Sept. 21-25 trip to Pakistan by Energy Secretary Hazel R. O'Leary. She'll lead a group of 70 American businesspeople on a visit that's expected to produce some \$3 billion worth of deals—everything from power-plant equipment to

solar energy systems. "O'Leary should get credit for doing something similar to Brown," insists one Energy staffer.

THE WHITE HOUSE

Does the White House have a woman problem? Except for his wife, President Clinton has no close women advisers. Now, top female staffers are bailing out. Cabinet Secretary Christine A. Varney is up for a Federal Trade Commission job. Margaret A. Williams, the First Lady's chief of staff, may depart. Political Director Joan Baggett and scheduler Ricki Seidman will exit under a reorganization. White House aides grouse that women are taking the fall for management failings.

BRAZIL



SHOPPING IN
SAO PAULO: THE
NEW CURRENCY
HAS HELPED
SLASH MONTHLY
INFLATION FROM
50% TO 1.97%

BRAZIL: IS THE RECOVERY FOR REAL?

If so, the country could become the dynamo of Latin America

For seven years, Kurt J. Meier, chief executive of General Electric do Brasil, has been nursing along an ailing joint venture that builds locomotives. Some foreign multinationals might have shut down the factory in Campinas because of the protracted slump in capital-equipment sales. But Meier made up for his losses with profits from electric motors, generators, and lightbulbs. Now, Meier thinks his long wait for a Brazilian upturn is about to be rewarded. "People just have to start believing in the country again," he says.

The reason is that Brazil seems poised for sweeping changes that could finally unleash its vast economic potential—and make it a locomotive for growth for all of Latin America. The launching of a new currency, the real, has helped slash inflation from 50% a month in June to just 1.97% in August. It has achieved

that thanks to a loose linkage to the dollar combined with such measures as lower import barriers and a curb on government deficits. The revival of consumer credit has triggered a spending surge, giving new strength to many industrial sectors.

WATCHING. The key question is whether October's election will help accelerate Brazil's embryonic recovery. Fernando Henrique Cardoso, the former Finance Minister who launched the currency reform, is the front-running presidential candidate. He is expected to win either in the first-round Oct. 3 vote or in a Nov. 15 runoff against leftist Luiz Inácio Lula da Silva. A convincing victory could give Cardoso the momentum to push through a broad agenda of even more aggressive free-market reforms.

The rest of Latin America is watching to see if this time Brazil will follow the

course of several neighboring countries that have conquered inflation, opened their markets, and attracted billions in foreign investment. With 160 million people, a \$500 billion gross domestic product, and Latin America's biggest industrial infrastructure, an economically stable Brazil could give a powerful boost to

the whole region, already racked up its fastest expansion in decades. "A stronger Brazil will benefit us all," Argentina's Economics Minister, Domingo Cavallo, told BUSINESS WEEK. "We feel that Brazil has a real chance of forming a government that is capable of running the economy well."

A Brazilian upturn would add to the boom in U.S. exports to Latin America. Betting on recovery, billions of dollars of foreign investment have been flowing into Brazil's stock market, pushing it up 92% so far this year (chart). Foreign companies also are increasing

direct investments. Brazil already has the biggest U.S. stake in Latin America, totaling \$16.9 billion at the end of 1990, against Mexico's \$15.4 billion—although Mexico has been catching up. Now, Compaq Computer Corp., for example, is opening a new, \$30 million plant in São Paulo to make 500,000 personal computers per year to sell throughout Latin America, and General Motors Corp. is planning a third auto factory.

SHOCK THERAPY. The economic revival could still go off track. After all, Brazil has had eight finance ministers, three currencies, and two economic-shock-treatment plans just in the past four years, all of which failed to tame inflation. Thus, Brazilians' hopes for the latest attempt, the Real Plan, are tempered with skepticism. São Paulo housewife Maria Gil Marques, for example, says she "adores" the plan, which has increased her purchasing power. "But after the elections, they're going to reveal the real inflation rate," she warns. "I don't believe it is just 2% or 3%."

Indeed, in the battle against inflation, "we're living through a truce," warns Roberto Teixeira da Costa, president of Brasilpar Financial Services. "1995 will bring us a bit of realism." To help Cardoso win, Brazilian business has held off price boosts—but the election will end that restraint. That could trigger demands from workers to tie their wages

a price index again, building in inflationary momentum. "If prices go up, labor will have room to demand indexation," cautions São Paulo Stock Exchange President Alvaro Avelar Vidigal.

Cardoso's gains against inflation could also erode if he is unable to convert an election victory into legislative approval of major new economic reforms. "These things have to be done right away, otherwise *clientelismo* will come back," says Vidigal, referring to traditional patronage and pork-barrel spending. Cardoso will face resistance even among election promises to curbs on such outlays. His closest ally, the Liberal Front Party, will want to keep the money flowing to the governorships and 1,100 municipalities that it controls.

Dramatic Opening. Despite the obvious challenges, most analysts believe the real economy is currently worth \$1.07, and the election are giving Brazil its best shot at economic stability in many years. "Brazil is surrounded by countries that have been successful in their economic planning," says John E. Hemus, president of Goodyear do Brasil, whose domestic tire sales are up 121% since 1992. "Brazilians look confident and know they could do it,"

Harvard economist Jeffrey Sachs, an adviser to many governments on inflation fighting, believes that Brazil has made a good start. Measures include \$10 billion in funds set aside by the Congress last February to give the federal government more control over social spending; an accord with creditors in April to restructure Brazil's foreign bank debt; and a buildup of hard-currency reserves to \$43 billion. A dramatic trade opening has slashed average import tariffs to 14%, down from 80% in 1985.

Spurred by such reforms, GNP is expected to grow by as much as 4% this year after a 5% rebound in 1993. The trade opening has forced industries to invest in new technology and slash



THREE MONTHS AGO, CARDOSO WAS TRAILING LULA BADLY IN THE POLLS. NOW, WITH INFLATION TAMED, CARDOSO IS FAR AHEAD—AND LULA IS TONING DOWN HIS RHETORIC ON PRIVATIZATION AND THE CURRENCY PLAN



workforces, while privatization has turned eight money-losing steel companies into profitable, technologically revamped producers. As a result, productivity has jumped 36% in the past three years, keeping Brazilian goods competitive worldwide and piling up huge trade surpluses, totaling \$15 billion last year. "I don't think we've ever had the combination of ingredients that we have today to profoundly change the country," says Israel Vainboim, president of Brazil Warrent, a banking and industrial conglomerate. He predicts growth averaging 7% to 8% a year over the next decade.

A crucial question is whether all this free-market economic activity can translate into tangible gains for individual

Brazilians, some 40% of whom live in grinding poverty. One sign that slower inflation is easing the squeeze on some family budgets: Sales at McDonald's restaurants in Rio de Janeiro and northern Brazil were up 7% in June, 30% in July, and more than 60% in August.

Such benefits of the Real Plan have helped Cardoso. As recently as mid-June, rival contender Lula, 48, a former union leader and candidate of the leftist Workers Party, was the front-runner in opinion polls with 38% of the vote against 23% for Cardoso, the candidate of the center-left Brazilian Social Democratic Party. Now, with inflation down sharply, their positions are reversed: Cardoso is scoring 43% against Lula's 23%.

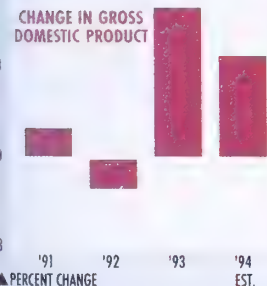
THINKING MAN? That means Brazilians, like other Latin Americans, are opting increasingly for economic stability, shunning Lula's message of social revolution at the polls. But Cardoso is offering more than an inflation-busting currency. He also has a reputation as a thinking man's politician. The 63-year-old sociologist and former senator was a professor at universities in São Paulo, Cambridge, Palo Alto, and Berkeley. His cautious air and reputation for honesty reassure many Brazilians that he would

impose order on Brazil's economic confusion. "Cardoso has the intellectual and ethical background to organize the state," says Pedro H. Mariani, president of Banco da Bahia, an investment bank in Rio de Janeiro.

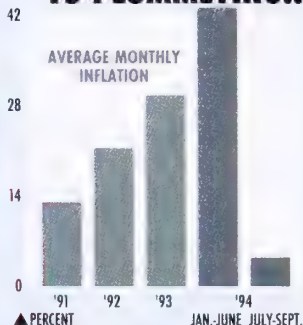
It's because of his sensible approach that many Brazilians, inspired by their nation's fourth World Cup soccer title, feel it's time for Brazil to stop sitting on the economic sidelines, watching as its smaller and leaner neighbors score big. Although there are big hurdles ahead, Brazilians seem ready to send Latin America's biggest player back into the contest.

By Geri Smith, with Bill Hinchberger, in São Paulo

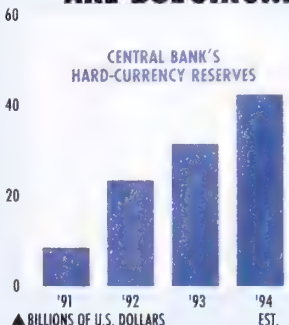
BRAZIL'S ECONOMY IS REVIVING...



...INFLATION IS PLUMMETING...



...RESERVES ARE BULGING...



...AND STOCKS ARE SOARING



DATA: IPC-FIPE, ICATU, UNIBANCO, SÃO PAULO STOCK EXCHANGE, IESP, CENTRAL BANK OF BRAZIL, BUSINESS WEEK ESTIMATE

A NASTY LITTLE SHOVING MATCH IN HONG KONG

Chinese threats against a Jardines project bode ill for 1997

For almost 150 years, China has borne a grudge against the Jardine group. In the 1840s, its drug trade helped start the Opium Wars. In the 1980s, the British group, whose businesses range from retailing to real estate, shifted its legal domicile from Hong Kong to Bermuda, demonstrating a lack of confidence in Beijing's ability to rule after 1997. This year, the Chinese blamed a Jardines director for allowing Governor Chris Patten's electoral reforms to pass.

Now a new conflict has erupted, with implications for Hong Kong and its huge concentration of U.S., Japanese, and other foreign investment. On Sept. 13, China said it would veto construction of a container-shipping terminal—expected to cost more than \$1 billion—as long as Jardines

led official: "Here you have clear evidence of Chinese unwillingness—for purely political reasons—to countenance a really good company's involvement in a project."

If politics has intruded into business, however, the Chinese insist that the British are responsible. The Hong Kong government, Beijing says, started the political game by granting Jardines the terminal project as a payback after Jardines director Martin Barrow, a member of the colony's legislative council, abstained during a crucial vote last spring on Patten's reform package. Barrow and Patten deny the charge.

On another front, Jardines is angering the Chinese by pulling out of the Hong Kong Stock Exchange. In March, Jardine Matheson and affiliate Jardine

ered is to expand the number of companies in the index from the current 33.

The latest row comes at an uncomfortable moment for British business executives. Worried about Chinese wrath after the Hong Kong elections, they have organized a delegation of some 100 top executives from over 70 companies.

Week after the Jardines flap broke out, those executives were getting a good reception in Beijing, but the tension was evident. "British companies are operating against an uneasy political background," admits Francis Cornish, British senior trade commissioner for Hong Kong.

SEEING A BRIGHT SIDE. Perhaps the most sensitive point of contention between China and Jardines is Beijing's fear, first expressed in December, 1992, that the company is supporting alleged British efforts to subvert and destabilize Hong Kong before 1997. Last January, Beijing officials used administrative rules to force the closure of several Jardine Transport Services offices in China. Yet until now none of its major business interests have been seriously threatened.

Other foreigners are hopeful that the impact of Jardines' disputes with China can be contained. Says one executive connected to the consortium: "If it's just a one-off hit on Jardines, that it shouldn't be a problem. The Hang Seng shrugged off the delistings announcements, trading in the same narrow range as before."

Optimists can even find a bright side to the dispute. In singling out the port project, the Chinese have shifted their attention away from Hong Kong's new airport. Now under construction, the \$20 billion project, with a large number of its contracts extending past 1997, has been an easy target for Chinese officials who want to take potshots at Patten. But many in Hong Kong suspect that even China's leader

now realize the airport's importance. That means Beijing could focus on the container port. "They need something to stick it to the British," says an executive with a U.S.-based company. "The terminal has got everything: visibility, a big British company with a bad colonial history." So more Jardines projects may be vulnerable, such as plans by Dairy Farm to open supermarkets in China. For a group with Jardines' scope—and history—China will have no shortage of targets to show its displeasure.

By Dave Lindorff in Hong Kong



THE MANDARIN ORIENTAL HOTEL: JARDINES IS TAKING ITS COMPANIES OFF THE HONG KONG EXCHANGE

was part of the consortium set to build and run it. Beijing can do that since the contract would extend beyond Britain's turnover of Hong Kong in 1997. With this threat, China has upped the ante in its efforts to shape Hong Kong's future. There was no mistaking the timing: The threat came just days before the first election under Patten's reforms, in which Beijing opponents won big.

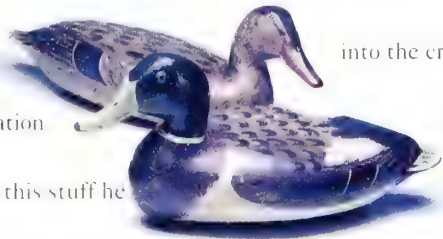
British officials say the affair shows that the Chinese are prepared to interfere in the integrity of the colony's economic decision-making. Says one frustrated

Strategic Holdings announced they would quit the local exchange, and in September Jardines affiliates Hongkong Land Holdings, Mandarin Oriental International, and Dairy Farm International announced similar moves. Jardines is leaving because it fears that after 1997, when securities rules will be set by China, it might be vulnerable to an unfriendly takeover.

In all, the Jardines moves mean some 10% of the Hang Seng Index will be delisted. To offset the pullout, Tony Chiu, manager at HSI Services, which compiles the index, says one option being consid-

WHY IT NEVER PROFITS TO RELY ON FIRST IMPRESSIONS.

Always take another glance. And always with an open mind. In some cases, it can save your neck; in others, it merely makes you rich. Too bad you can't hear it from a certain fellow who, in 1818, was drilling for salt at the mouth of Kentucky's Troublesome Creek — and inadvertently struck oil instead. Of course, he had no idea what he had found, or what one might do with it. He worked feverishly to plug the thing up with sand. Despite his efforts, the oil flowed into the creek and then into the river, where it ignited. A tremendous conflagration ensued, and it destroyed his salt works. The man cursed wildly at this stuff he called "devil's tar."



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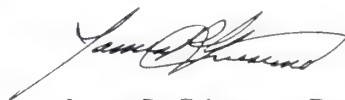
Five years ago, Bill Daniels challenged the University of Denver to turn the page on graduate business education. We have enough MBAs who are technical wizards, he said. Turn out business professionals who are prepared to become leaders. People who are as committed to their communities, their industries and companies as they are to their own careers. Young men and women with a clear sense of values, integrity and professional protocol who communicate effectively, problem-solve creatively, **and** have top-notch technical skills.

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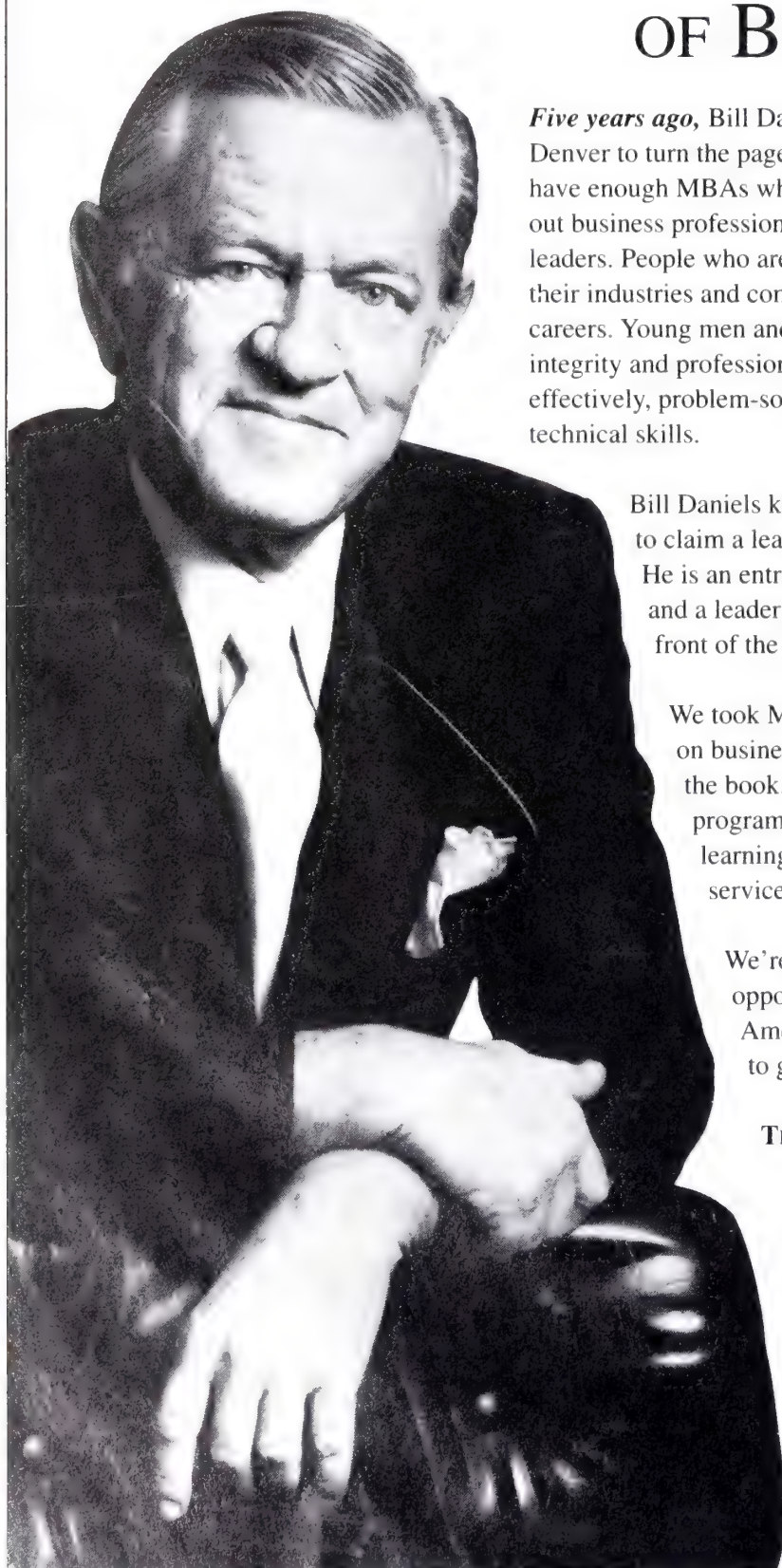
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Daniel L. Ritchie, Chancellor



UNIVERSITY of DENVER



FRANCE'S SOCIALISTS HAVE A PRAYER HANGING ON TO THE ELYSEE?

he 14-year reign of Western Europe's longest-ruling postwar leader, French President François Mitterrand, is reaching its end. Socialist Mitterrand, who turns 78 in September, is fighting a tough battle against prostate cancer, and might have to quit even before his term ends next May. Mitterrand has contributed to the *fin-de-régime* atmosphere by talking publicly about his mortality and slyly maneuvering to ensure the succession.

Mitterrand should exit this fall, early elections would favor Prime Minister Edouard Balladur. In the meantime, this moderate, unflappable technocrat is the head of his fellow Gaullist, former Prime Minister Jacques Chirac. Balladur's advantage has been greatly reduced, however, if Mitterrand manages to hang on until the scheduled April elections.

Whenever he goes, Mitterrand's departure will well end the Socialist era in France. He has already hurt his own party badly by admitting his involvement with pro-Nazi leaders of the World War II Vichy regime. And in summer, Mitterrand's encouraging rivals in the European Parliament vote destroyed the chances of the party's preferred presidential candidate, Michel Rocard.

OF SCANDALS. The Socialists' slim hopes rest on European Commission head Jacques Delors, who is being coy about whether he'll even seek the French presidency. Delors looks good in the polls now, trailing Balladur by only a few points—and ahead of Chirac. But there are doubts about whether this sometimes brittle official has the grit for what promises to be a nasty campaign. His overly ambitious leadership in Brussels would undoubtedly come under attack.

Still, it's striking that any Socialist could even hope to defeat Mitterrand, given the party's deep scars from repression and a wave of scandals. But the scandals, whose

emergence at this stage in the political cycle is not coincidental, are tainting the right as well. In the latest probe, Industry Minister Gérard Longuet is suspected of using influence to build a Saint-Tropez villa on the cheap.

Although ill, the wily Mitterrand is still managing to hurt the right. By staying on cordial terms with Balladur, he has encouraged the Prime Minister's presidential ambitions. That is setting up a damaging fight between Balladur and his onetime patron, Chirac. While Balladur is more popular, Chirac has a big advantage in funding and organization.

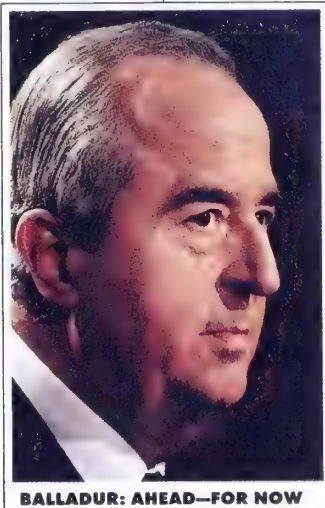
BUDGET BUSTER? Mitterrand is also building up former centrist Prime Minister Raymond Barre, whose entry as an independent candidate could further split the right. And the President is taking the lead in trying to recruit Delors—even though the two men were known to dislike each other during Delors' term as Finance Minister from 1981 to 1984.

Even if Delors wins, he won't bring back the big-spending, state-capitalist France that Mitterrand once stood for. As in other countries, the financial markets call most of the political tunes in today's France. Delors would likely stick to Balladur's recipe of a strong franc and tight budgets.

Balladur has done a commendable job of selling such policies as necessary to make France competitive. Analysts worried that Balladur might spend heavily this fall to cut France's 12.6% unemployment and win votes, but his new 1995 budget features the biggest deficit cut in 30 years.

Strangely, the markets are more concerned about the right-leaning Chirac, who might put growth and job-creation above a strong currency—as some French business leaders urge. But if there is a threat to the business climate, it lies more in the muck the campaign will stir up than in the candidates' policies.

By Stewart Toy in Paris



BALLADUR: AHEAD—FOR NOW

REAL WRAPUP

SWEDEN TILTS LEFT

Sweden's voters veered sharply left in Sept. 18 elections, toppling the center-right coalition of market reformer Carl Bildt. But the new Prime Minister, Social Democrat Ingvar Carlsson, takes office in a weak position. He doesn't control enough votes for outright majority in Parliament, so he'll need the support of groups he dislikes—the leftist Green Party or the former Communist Party, now called the Left Party—which want to restore social spending. The result could be months of turmoil. "It's the worst possible outcome," says one investment banker. Carlsson will be further inhibited

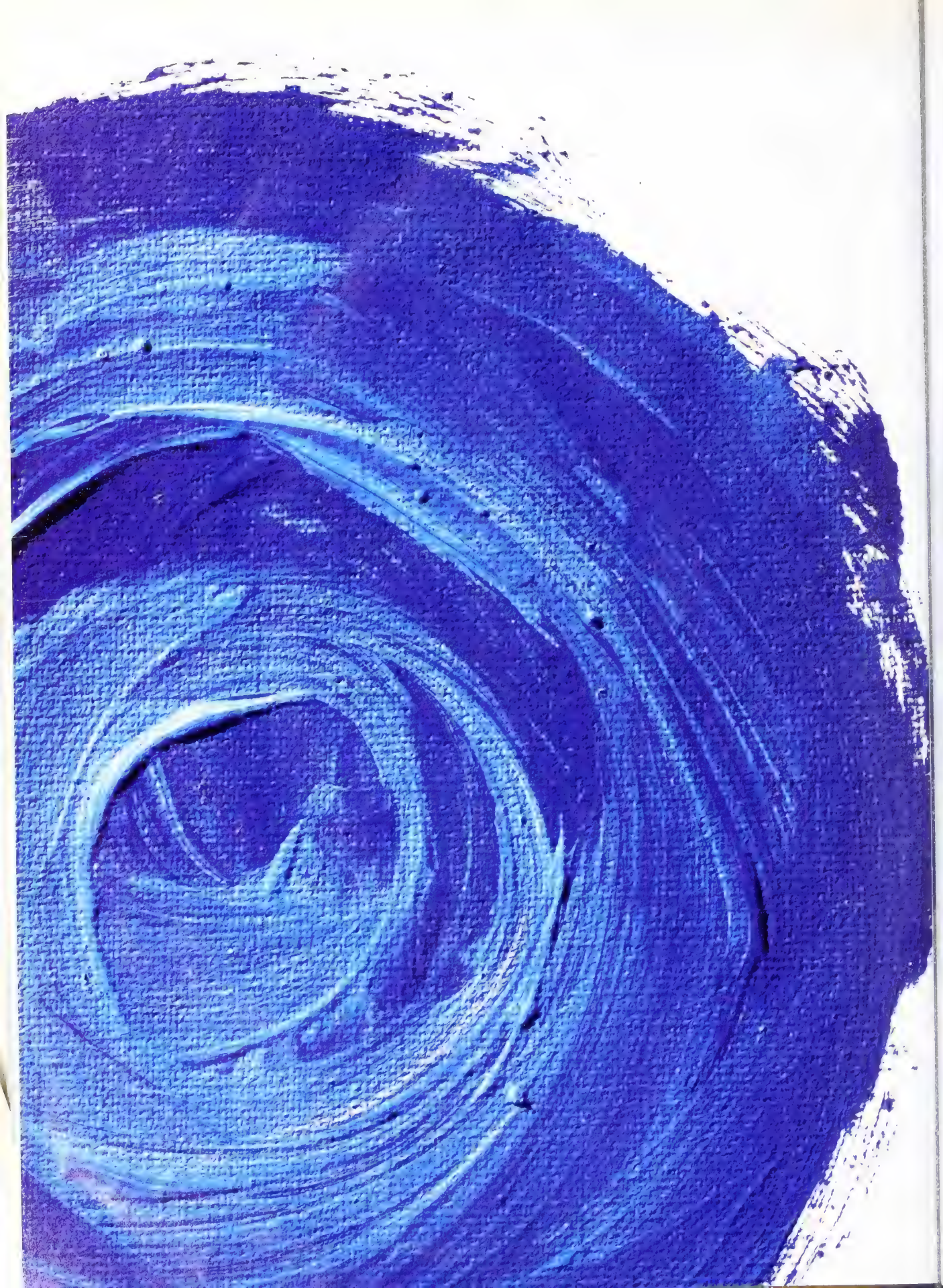
by the upcoming Nov. 13 referendum on joining the European Union.

NUMERO UNO IN CUBA

Mexico has been cementing its status as the leading foreign investor in Cuba. Mexpetrol, a joint venture of Pemex, Mexico's state-owned oil company, and several private industrial and engineering companies, has purchased a 49% holding in the Cienfuegos refinery in Cuba. The Mexicans have made a \$200 million investment with Cuba's oil company, Cupep. The infusion of capital is aimed at modernizing the refinery in order to allow Cuba to earn hard currency by exporting oil.

NEC INVESTS IN SCOTLAND

After months of fierce lobbying, NEC Corp. says it will invest \$827 million in a new chip plant in Scotland. California was the other strong contender. NEC's current 13-year-old plant in Scotland is its most productive worldwide. That influenced NEC's decision to expand the operation, as did Scotland's low labor costs and strong demand from Europe. The new facility will eventually make 64-megabit semiconductor chips and will employ 430 workers. Motorola Inc., too, recently announced a \$384 million expansion of its Scottish chip plant—its largest investment in Europe.





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THAT BURNING SENSATION AT GLAXO

With growth slowing, the drugmaker nervously hunts for alliances

Few corporate leaders have had as big an impact on their companies as Paul Girolami. During his 13-year tenure as CEO and then chairman of Glaxo Holdings PLC, he transformed the British drugmaker into a world pharmaceutical giant second only to Merck & Co. And he did it in true bootstrap fashion. Fiercely opposed to acquisitions, which he felt would distract Glaxo from its research focus, Girolami, an Italian-born immigrant, spent lavishly on developing blockbuster drugs. Glaxo's most successful: Zantac, an ulcer-fighting medication that remains the world's top-selling medicine.

But now, as the 68-year-old Girolami prepares for retirement in November, Glaxo is entering a period of profound uncertainty. Sales of its aging powerhouse drug are likely to weaken in the next few years. And there are no megahits in Glaxo's pipeline to immediately take Zantac's place. Worse, industry insiders believe Girolami's go-it-alone strategy has left the company at a competitive disadvantage. That's especially true in the all-important U.S. market, which accounts for more than 40% of Glaxo's sales and where behemoths such as Merck & Co. and SmithKline Beecham PLC have scrambled to acquire smaller competitors and drug distributors. "The foundations of our business are changing," Girolami acknowledges.

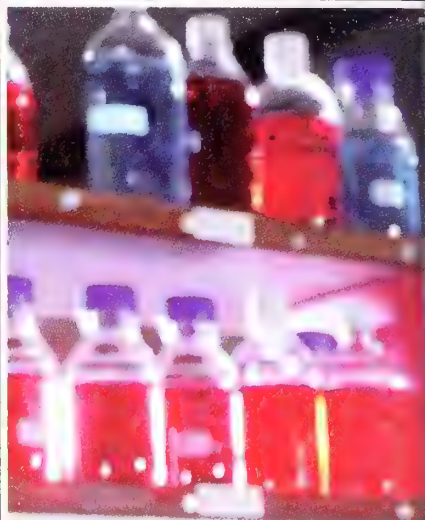
MAJOR SHIFT. Things will change at Glaxo, too, under Girolami's successor, CEO Richard B. Sykes. Glaxo's new top man is exploring possible acquisitions and joint ventures to offset slowing sales in coming years (chart). True, many of the more obvious targets, such as Medco, have already been snapped up. That's why many in the drug industry, as well as Wall Street, believe Sykes will have to set his sights even higher to have a sufficient competitive impact. Among the rumored possibilities: a deal with Eli Lilly or Warner-Lambert Co. (page 78). Glaxo needs "a strategic alliance or a combination," says a former senior executive at a rival company. "I

don't think they're going to have a choice." Says Sykes, a plain-spoken Yorkshireman: "We haven't ruled anything out."

Sykes's ascendancy clearly signals a major shift in strategy at Glaxo. For Glaxo to contemplate a merger would have been unthinkable during the height of Girolami's reign. An accountant by training, Girolami always argued that new products alone were the key to growth. And he quickly dispatched anyone who doubted that wisdom. Ernest Mario, Sykes's predecessor as CEO, resigned in March, 1993, after pressing for the acquisition of Warner-Lambert to gain entry into the lucrative over-the-counter drug market. "There was not blood on the carpet," says Richard E. Southwood, an Oxford University zoology professor and Glaxo board member. "There was a difference of opinion about what direction the company should follow."

In recent months, as mergers multiplied in the industry, insiders say that the board realized it was time for a change at the top. The company's revenue and profits are expected to slow in coming years as sales of the 13-year-old Zantac start to ebb. The drug is already under attack by cheaper generics and a new generation of antiulcer drugs, such as Astra's Prilosec.

Zantac is likely to face even stiffer

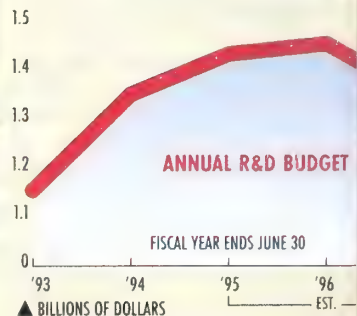


challenges from a raft of new competitors now that SmithKline Beecham's patent for Tagamet, an ulcer drug similar to Zantac, expired in May. And Glaxo's own patents on Zantac begin expiring in 1996. Salomon Brothers Inc.'s Peter A. Laing predicts Zantac's sales could be nearly halved by 1997, to \$2.2 billion.

All that translates into a severe bottom-line headache for Glaxo. Last year Zantac's sales accounted for 43% of



GLAXO'S SLOWING R&D SPENDING...





NEW CEO RICHARD SYKES SAYS THE COMPANY WILL SEEK PARTNERS AND REMAIN RESEARCH-INTENSIVE

could decline by 7% from this year's expected results, to just under \$3 billion, estimates Laing, as revenues drop 2%, to \$9.2 billion.

That scenario has already made investors jittery. Glaxo's stock has fallen by a third, to just 9, from its all-time high of over 14 in 1992. Last year, institutional investors began pressuring the board for change at the top, say insiders. On June 15, Girolami announced his departure—more than a year ahead of schedule. "Everybody agreed with me it was the right time to go," says Girolami. "As someone said to me, 'Even your shadow is too strong.'"

Unlike his predecessor, Sykes grew up on the research side of Glaxo's business. He first joined the company as a microbiologist in 1972 and later spent seven years at the

Squibb Institute for Medical Research. Returning to Glaxo in 1986, he swiftly rose through the ranks, eventually supervising research and development efforts. Sykes, now 52, is credited with managing Glaxo's huge R&D buildup. The company's research budget went from \$176 million in 1986 to \$1.3 billion last year.

Still, there are some similarities between the two. Like his boss, Sykes be-

lieves Glaxo's huge research machine is critical to the company's future. A striking symbol of this commitment can be found in Glaxo's sprawling new 73-acre research campus at Stevenage, north of London. Costing more than \$1 billion, the nearly completed project will bring more than 1,000 British researchers under the same roof for the first time. Sykes is expected to increase Glaxo's R&D spending by 6% this year, to \$1.4 billion, second only to Merck in the drug industry.

PRICING PROBLEMS. Generous budgets alone don't guarantee top-selling drugs, however. Imitrex, Glaxo's promising antimigraine drug, has run into price resistance. European governments are up in arms at what they consider the drug's unreasonable cost, \$30 a dose. A complaint by the Danish government has triggered an investigation into Glaxo's pricing by the European Commission. Meanwhile, France's powerful drug agency has refused to give Imitrex final marketing approval until Glaxo lowers the price.

Without a Zantac replacement, Glaxo could have a hard time sustaining its costly sales force and huge research outlays. Sykes expects that R&D spending will start to drop off at many drug companies in the next few years, because the drug market is so fragmented that it's difficult to generate huge growth in sales volume. But he insists Glaxo will remain a research-intensive company.

It's largely because of his inability to find homegrown solutions to Glaxo's problems that Sykes is looking for outside help. On the R&D front, he recently forged alliances with 10 small research boutiques. Two promising products in Glaxo's pipeline—Lamivudine for hepatitis B and 3TC for HIV—come from BioChem Pharma Inc., a small research company in Laval, Quebec. Analysts estimate both drugs could generate combined revenues of \$78 million for Glaxo by 1997. And sales could rise dramatically by the end of the decade.

Sykes is also seeking out partners to help Glaxo's marketing efforts. Just months after Sykes became CEO last year, Glaxo entered into a partnership with Warner-Lambert to market over-the-counter versions of its medicines. That way, Glaxo hopes to extend the life expectancy of some of its major drugs. In Britain, Warner is marketing Glaxo's allergy drug to fight rhinitis, Beconase. Glaxo, meanwhile, has applied for regulatory approval to sell a less-potent version of Zantac over-the-counter in Britain. It plans to seek similar permission in the U.S. in October.

Still, the best cure for Glaxo's future worries may lie in a full-fledged acquisition or joint venture with another drug

Glaxo's 1994 revenues and perhaps more than 60% of its profits. Given time and more intensive marketing, some of Glaxo's drugs could eventually emerge as blockbusters. But Laing figures the megamaker's traditionally strong earnings growth could start slipping in a couple of years. In the fiscal year ended June, pretax profits rose 10%, to \$2.9 billion as sales climbed 15%, to \$8.8 billion. But by fiscal 1996, pretax profits

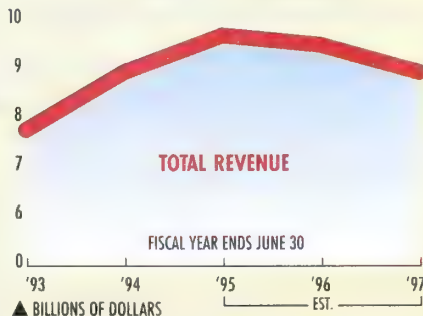
AND MODEST MENU OF NEW PRODUCTS...

of Zantac expected to drop 44% by 1997, \$1.1 billion, Glaxo has no megahits to take its place immediately. Its major new products include:

Use	Global launch date	Projected sales by 1997 Millions
MIGRAINES	1991	\$1,132
ASTHMA/RHINITIS	1993	\$484
ULCERS	1994	\$187
HIV/HEPATITIS B	1995	\$78
		TOTAL: \$1,881

SOURCE: COMPANY REPORTS, SALOMON BROTHERS INC.

...COULD SPELL TROUBLE AHEAD



The Corporation

giant. Glaxo is sitting on a cash pile of \$3.5 billion and analysts reckon it could easily finance a deal worth five times that amount. Sykes acknowledges that Glaxo's financial strength "gives us a strong position in a marketplace which is relatively unstable." But he cautions against assuming that he will chase after the first available drug distributor. Instead, a future alliance with another drugmaker is possible, says Sykes.

DIRECT SALES. Indeed, the CEO suggests that a drug distributor may not turn out to be the ideal merger candidate as the health-care system evolves toward "disease management." Under such a system, Sykes says, consortia of drugmakers, insurers, and managed-health-care providers would cooperate to deliver service and offer better value—eliminating the need for distributors.

If that happens, Sykes argues that

Glaxo would be better off negotiating deals directly with health-maintenance organizations—and even with big corporations that could pressure insurers to buy certain drugs. Thanks to a special sales force established in 1986 to market directly to HMOs, Glaxo has a significant share of the managed-care market. The company recently

set up a sales group to call directly on big corporations. "We're not trying to sell yet," says Robert A. Ingram, CEO of Glaxo Inc., the U.S. unit. "We're trying to build relationships."

So for now, Sykes says he sees little



GIROLAMI CHOSE TO FLY SOLO

need to rush into a deal. True, the linking of competing drugmakers with distributors may restrict market access, but Sykes says he has found "no door closed to us yet." Moreover, he contends that innovative medicines will always be sought after by distributors—even if they are owned by rivals. Through the year, Glaxo has adequately

demonstrated its scientific strength. Now it's up to Sykes to prove that Glaxo's management has some deal-making prowess as well.

By Julia Flynn in London, with Joseph Weber in Philadelphia

LISTENING TO PROZAC—AND ZESTRIL, AND...

When it comes to dealmaking, Glaxo Holdings PLC clearly has the interest—and the money. It's Glaxo's timing that may be a little off. CEO Richard B. Sykes confirms that Glaxo held talks with McKesson Corp.'s PCS Health Systems and Diversified Pharmaceutical Services earlier this year—only to have both drug benefits managers snapped up by competitors. SmithKline Beecham snared DPS for \$2.3 billion, while Eli Lilly & Co. got PCS for \$4 billion.

Now, after the global drug industry has struck some \$36 billion worth of deals in the past year, Glaxo is still without a partner. But that could change before the end of the year, say analysts, consultants, and industry executives, who are keenly awaiting a big deal by Glaxo. Even Glaxo insiders acknowledge that the company is scouting out prospects. "So many kites have been flown," says one.

"UNBELIEVABLE." For now, a deal with Lilly seems the odds-on favorite. It's widely rumored throughout the industry that executives at Glaxo and Lilly are already talking about a friendly alliance, though neither will comment. In many ways a Glaxo-Lilly link makes sense. For starters, such a deal would protect Glaxo's access to the U.S. market if the PCS deal goes through later this year. Lilly has suggested it might want a partner to help pay for PCS. Moreover, Glaxo would give Lilly an expanded menu of products to feed PCS.

A merger with Lilly would also help Glaxo fill out its product line. The big prize: Prozac, Lilly's blockbuster antidepressant. It would be "an unbelievable deal," says a consultant whose firm works closely with Glaxo, "It would also scare the hell out of everyone else."

There are plenty of hurdles, though. Since a takeover requires approval from 80% of Lilly's shareholders, it might be tough to pull off—especially with 20% of the stock controlled by the Lilly family and employees. But the biggest dealbreaker might be the price tag: \$24 billion, estimates Carl

Seiden, an analyst at Sanford C. Bernstein & Co. Still, analysts say that doesn't preclude a stock swap or a joint venture.

Warner-Lambert Co. is also frequently mentioned as a possible partner. But most analysts and drug executives doubt Glaxo wants a company best known for its over-the-counter business. Instead, they suggest that Glaxo might acquire the company's prescription-drug unit. Warner has seven new drugs in late-stage testing, including Omnicef, an anti-infection drug. Such an acquisition would also be cheaper than a megadeal with Lilly, possibly costing as little as \$6 billion.

There are all sorts of dark-horse candidates rumored to be on Glaxo's list as well. Among the favorites: Britain's Zeneca Holdings PLC, which was spun off from Imperial Chemical Industries PLC last year. Sales of its antihypertensive Zestril and cancer anaesthetic Diprivan both grew more than 40% last year, to a combined \$967 million. Glaxo might also prefer a research-intensive company that's badly in need of some marketing clout. One possibility: Wellcome PLC, which dominates the antiviral drug market. Even after months of frenzied industry deal-making, analysts agree there are plenty of potential partners. It's just up to Glaxo to settle on the timing.

By Julia Flynn in London, with Joseph Weber in Philadelphia and Susan Chandler in Chicago

POSSIBLE PARTNERS?

Analysts speculate that Glaxo is studying mergers or joint ventures with the following companies:

ELI LILLY

An alliance with this giant drugmaker would improve Glaxo's U.S. distribution and give it access to the antidepressant Prozac.

WARNER-LAMBERT

Company could sell its prescription drug unit to Glaxo. Such a deal would allow Warner to concentrate on the over-the-counter market.

ZENECA

Company would broaden product portfolio with fast-growing drugs such as the intravenous anesthetic Diprivan.

DATA BUSINESS WEEK

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is that they're just synaptic
meanderings –

gossamer
mind fiction –

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DILLARD'S HAS DILLY OF A HEADACHE

everyday-low-price policy isn't luring enough customers

For most of the past decade, Dillard's Department Stores Inc. could do no wrong. While retailers such as Federated Department Stores Inc. and J.C. Penney Co. languished in bankruptcy, Dillard's well-timed strategies for merchandising, cost-cutting, and expansion led to robust growth. From 1983 to 1993, the Little Rock-based Dillard's rose to the nation's

of revenues at Dillard's, which runs 232 stores mostly in the South and Southwest. Still, rivals such as May Department Stores Co. and Dayton Hudson Corp. have weathered the downturn fairly well.

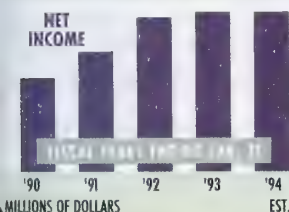
Retailing experts say Dillard's has made matters worse for itself by sticking with a marketing strategy that does not seem to be working. Since the mid-

and say, 'I'll wait until it goes on sale.'"

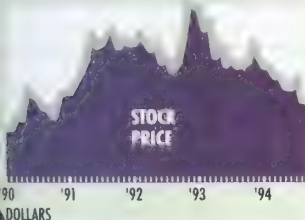
These days, Dillard's has just two clearance sales a year, down from a sale a week. But they're the exception that proves the rule: Tonya Goodwin, who isn't a regular Dillard's shopper, was drawn to its Northpark Center store in Dallas recently after seeing an ad for a summer clearance sale of 50% to 66% off regular prices. "I search the newspapers all the time for sales, and I usually shop at the stores offering the best deals," says Goodwin, a 35-year-old paralegal.

BIG MARKDOWNS. The risks in Dillard's everyday-low-pricing strategy didn't become apparent until the severe slump hit women's apparel—and rivals pumped up promotions to move merchandise. Shoppers began passing up Dillard's for competitors such as May and Dayton Hudson, which run constant sales. Not

DILLARD'S PROFIT SLOWDOWN...



...IS HAMMERING ITS STOCK



DATA: COMPANY REPORTS, NATWEST SECURITIES, BRIDGE INFORMATION SYSTEMS INC.



largest department-store chain as its store base more than tripled, to 227. Meanwhile, sales grew sixfold, to \$5.1 billion, and profits grew even faster, to \$1.1 million from \$34.1 million.

Lately, though, Dillard's seems to have lost its golden touch. For the first time of the year, net income slid 6.2%, to \$1.1 million, even as sales climbed 8.5%, to \$2.56 billion. Its stock is around 28, down from 41¢ a year ago (charts).

What happened? In part, Dillard's has simply been suffering along with the rest of the department-store industry, which has been pummeled by weak sales in women's apparel. Women's clothing and accessories account for some 40%

of revenues at Dillard's, which runs 232 stores mostly in the South and Southwest. Still, rivals such as May Department Stores Co. and Dayton Hudson Corp. have weathered the downturn fairly well.

But department stores have typically shunned the formula. With their seasonal and fashion-oriented merchandise, the stores must mount frequent sales in order to make room for new goods. And their customers have learned to wait. "What draws people to a department store is the thrill of a bargain," says analyst Linda R. Morris of PNC Investment Management & Research. "They look at Dillard's and its everyday low prices

that Dillard's prices are necessarily any higher. Officials say its everyday prices are comparable to those offered by rivals during their sales. But perceptions matter. "In theory, it's nice to have everything sharply priced every day, but it doesn't work when competitors are out there running six-page sale ads every week," says analyst Robert F. Buchanan of NatWest Securities Corp.

Dillard's paid the price in the second quarter. Saddled with high inventories of spring and summer clothing, the chain was forced to take big markdowns. That pushed gross profit margins down to 34.58%, compared with 35.74% in 1993's second quarter. The margin pressure re-

sulted in a 14% decrease in earnings.

In a written response to BUSINESS WEEK, 79-year-old Chief Executive William T. Dillard, who founded the chain in 1938, says the company is "working to more fully implement our everyday pricing," especially in women's apparel. The yo-yoing prices of promotional stores, he says, alienate shoppers. Dillard believes promotions make retailers less efficient, adding that they take effort and they make business uneven. Dillard still oversees the chain, with day-to-day operations handled by his three sons.

Its pricing policy isn't the only thing giving Dillard's headaches now. A strong private-label business, for example, could give it more flexibility in dealing with fashion swings. If pricey brand-name stuff isn't moving, it could push house brands, which generally offer consumers a better value and

the retailer better profit margins. But Buchanan figures such lines account for only about 8% of sales at Dillard's, compared with 30% at Nordstrom Inc. and 50% at J. C. Penney Co.

ON THE PROWL? William Dillard says the chain is planning to expand its private-label line as quickly as possible, but it will take the time to do the job right. In addition, while beefed-up home-furnishing departments have been fueling growth at rivals, Dillard's has been cutting back on home items. In 1993, company sales of such merchandise accounted for 11.7% of revenues, compared with 17.2% in 1988.

Lately, Dillard's hasn't even been able to rely on acquisitions—which fueled growth during the 1980s—to help lift sales and profits. It made none last year and hasn't made a major purchase since 1990. Dillard's says it's actively pursuing deals, adding that it is interested in some of the R. H. Macy & Co. stores in the Southeast that may become available after Macy merges with Federated. But because Dillard's is usually a cautious bidder, it could well lose the stores to more aggressive competitors.

Despite Dillard's recent woes, retailing experts point out that it is still one of the best in the industry at controlling costs, thanks to state-of-the-art distribution and information systems. So it could be poised for a quick comeback when the women's apparel business picks up. Until then, it looks as if Dillard's shareholders will have to get used to everyday low prices, too.

By Stephanie Anderson Forest in Dallas



CEO DILLARD: NOT BIG ON PROMOTIONS

Media

TELEVISION

SO YOU WANT TO START A NEW NETWORK?

A vicious market is awaiting Herb Siegel's venture with Paramount

Talk about lousy timing. Chris-Craft Industries Inc. and Paramount Communications Inc. were about to disclose that they had lured the highest-ranking woman in broadcasting, former Fox Broadcasting Co. Chairman Lucie Salhany, to run their new TV network. But some bad news overtook the good a few days before the Sept. 15

Star Trek as a major selling tool. For Viacom Inc., which owns Paramount and may merge with Blockbuster Entertainment Corp., the troubles at *Star Trek: Voyager* are a distant rumble in a vast media empire. Not so for Chris-Craft. The powerful TV-station owner is taking on a major risk with the United Paramount network. It will

put up all the money for the network, at least initially. And it is launching the venture into an increasingly competitive market.

STUDIO SCRAMBLE. Such a roll of the dice is uncharacteristic for Chris-Craft Chairman Herbert J. Siegel. Though he once owned a talent agency with clients such as Jackie Gleason, Siegel is best known as a canny investor who made hundreds of millions on investments in 20th Century-Fox Film Corp. and Warner Communications Inc. As a Warner board member, the parsimonious Siegel assailed Warner Chairman Steven J. Ross for his profligate style. "Herb is almost the personification of a prudent investor," says Siegel's



I LOVE LUCIE Salhany, who rose to the top at Fox, has been signed by Siegel to run United Paramount. But the field is crowded—and the cost enormous

announcement: Actress Genevieve Bujold abruptly quit her starring role as the captain on the network's marquee show, *Star Trek: Voyager*.

Bujold, who complained that she was unprepared for the rigors of a weekly series, was quickly replaced by actress Kate Mulgrew. But in Hollywood, where showbiz often obscures real business, TV executives were muttering darkly that the turmoil could destabilize the United Paramount network, which Chris-Craft and Paramount plan to start in January. Salhany, who has been hired in part to lure more affiliates, must rely on this latest installment of

friend and former lawyer, Arthur L. Man. Siegel declined to comment for this article.

Now, though, he has taken on a project worthy of Ross. Nobody has launched a new network since Rupert Murdoch in 1984, and he lost nearly \$25 million before Fox broke even. Murdoch also didn't have to contend with today's hothouse climate. After a fallow period the Big Three networks are racking up record profits. Fox itself has become a powerhouse, thanks to pro football and an affiliate deal with Ronald O. Perleman. And Time Warner Inc.'s Warner Bros. is also starting a network, which

compete for viewers and affiliates United Paramount.

That's more, Chris-Craft will have to do much of the heavy lifting itself. Although the network was originally envisioned as a joint venture with Paramount, Chris-Craft ended up accepting a better deal in July, after Viacom agreed to pay all the expenses of the network for the first two years—a minimum of \$150 million. Viacom will compensate Chris-Craft for half of this investment after Viacom exercises an option to take a 50% stake in the network, sometime before January 1, 1997. In effect, Siegel has given Viacom a bridge to keep his debt-laden partner on board.

Siegel has every reason for clinging to Viacom. Like other station owners, Chris-Craft is anxiously trying to get into programming for its own line of independent stations. (Siegel sold the boatload of stations years ago.) That's coming more and more difficult, as Hollywood studios scramble to align themselves with existing networks. Even as it tops up the WB Network, for example, Time Warner is considering an acquisition of NBC Inc. By allying with Paramount, Chris-Craft gets a steady supply of programming such as *Star Trek*. In return, Paramount receives guaranteed distribution for its shows.

DOUBTS. Chris-Craft and Paramount have a more ambitious goal, though. By joining Siegel's six powerful independent stations to Paramount's *Star Trek* franchise, the companies hope to construct a blown network. They have lined up 41 stations to receive an additional two nights of prime-time programming. United Paramount won't be much like CBS or even Fox in the first few years. But industry executives say Chris-Craft and Paramount expect the network to be profitable in 85% of the nation's television households by its January launch.

For now, Chris-Craft and Paramount seem to have the edge in the race with the Warner network. While WB claims it has affiliates that cover more than 70% of the country, industry executives say Warner is counting WGN, a superstation it picked up

through its alliance with Tribune Co. Subtract WGN, these executives say, and WB's reach is still under 40%. Neither of the two networks are releasing current figures on coverage or number of affiliates. Observers say United Paramount has succeeded by offering independent stations compensation in return for carrying its programs. Time

preempt the Paramount network shows."

Still, few experts are sanguine about the prospects of either network. Richard Kurlander, director of programming at ad-sales representative Petry Television Inc., points out that Fox had 90% coverage when it started. With Chris-Craft's New York and Los Angeles stations, United Paramount is well represented in big markets, but Kurlander says its lineup is far weaker in small markets. He also questions whether Chris-Craft and Paramount will be able to stamp a distinctive identity on the network. "What's the niche?" asks Kurlander. "And how do you find a fifth and sixth niche?" Salhany has indicated that United Paramount will go after young, male viewers, much as Fox does now.

MOVING EYES? Even if Chris-Craft can clear those hurdles, it has to contend with a turbulent media landscape—and that could alter its agenda or that of its partner. Some observers expect Viacom to pursue CBS or NBC, which are both unofficially for sale, if its proposed merger with Blockbuster goes through. Viacom insists that it is fully committed to the network: "We're very optimistic about its prospects," says Viacom CEO Frank J.

Biondi Jr. But that doesn't preclude Viacom from looking at other networks, say sources close to the company.

For that matter, Chris-Craft has kept its options open. Several months ago, Siegel explored a joint venture with Sony Corp. to buy a network, according to investment bankers familiar with the discussions. With \$1.5 billion in cash and marketable securities on its balance sheet and no debt, Chris-Craft has the muscle to do a sizable deal. The company has also shared in the general revival of TV: Its net income tripled in the first half of 1994, to \$28.3 million, on revenue of \$228 million.

Given Siegel's tight-fisted reputation, few media executives would be surprised if Chris-Craft completely sat out the current wave of dealmaking. Then again, he's already following in the footsteps of a confirmed wheeler-dealer: Rupert Murdoch. Just don't tell Siegel he's anything like Steve Ross.

By Mark Landler in New York, with Ronald Grover in Los Angeles



STAR TREK: THE NETWORK IS COUNTING ON VOYAGER TO LURE AFFILIATES

Warner, by contrast, is asking prospective affiliates to pay for the privilege of being a part of the WB Network.

Salhany may further bolster United Paramount. At Fox, she earned a reputation for cultivating warm relationships with affiliates. "Lucie's salesmanship is vital," says John Tinker, a media analyst at Furman Selz, "because stations can

CHRIS-CRAFT, STEM TO STERN

Key holdings and investments of Chris-Craft Industries

INDEPENDENT TV STATIONS WWOR (Secaucus, N.J.), KCOP (Los Angeles), KPTV (Portland, Ore.), KMSP (Minneapolis), KBHK (San Francisco), KUTP (Phoenix)

NETWORK AFFILIATES KTVX (Salt Lake City, ABC), KMOL (San Antonio, NBC)

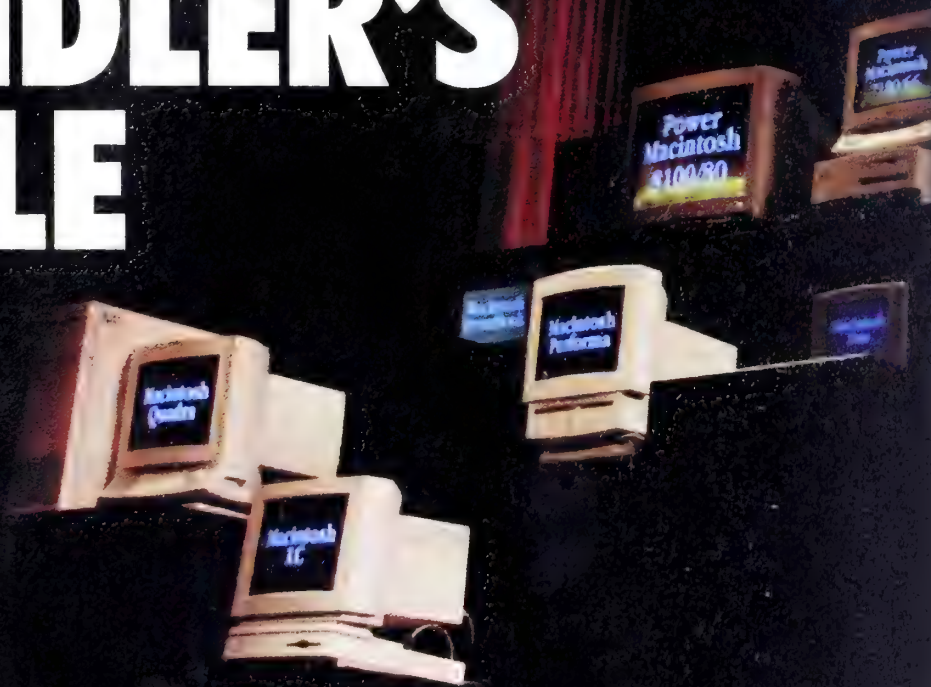
TV NETWORK Has pledged at least \$150 million to build a fifth network, starting in 1995

BALANCE SHEET Has \$1.5 billion in cash and marketable securities, primarily from its sale of preferred stock in Time Warner

DATA: COMPANY REPORTS

SPINDLER'S APPLE

It's in shape again. But it needs big market gains to keep up



In the black expanse of the theater in the Las Vegas Aladdin hotel, a single spotlight beats down on Michael H. Spindler, the new CEO of beleaguered Apple Computer Inc. It's the annual rah-rah rites for 2,000 sales reps. But this time it's different. It's October, 1993: do-or-die time.

The barrel-chested executive paces the stage as he assures the troops things are getting better. In the past five months, they have lived through a precipitous falloff in Macintosh sales, the ouster of CEO John Sculley, massive layoffs, and a mind-numbing, \$188 million quarterly loss. But, says Spindler, the worst is over. He whizzes through plans to replace Apple's willy-nilly ways with more accountability, and he urges his audience to be aggressive, shouting: "This is not a lame-duck company!"

Then, he closes with what he warns will be "very personal." When the board offered him the CEO job on June 17, he says, he was given 15 minutes to decide. The easy way, he says, would have been to say: Thanks but no thanks. "I

could see myself being a grandfather sitting with a grandchild on my lap in a tomato field saying: 'I didn't have to be CEO,'" says the 51-year-old executive. Suddenly, his eyes tear up. His voice wavers, and he delivers a last sentence, his fist raised to the roof. "The reason why I made this 15-minute decision is: We can win this!"

It was a startling moment. Here was the no-nonsense German pragmatist, known as the Diesel for his hard-charging business style, exposing a whole different side of his personality. Spindler, after all, was the man who, in rapid-fire but heavily accented English, had always insisted that his

managers stick to the facts, lay off the hyperbole, and back up their plans with numbers, analysis, and objectives—and stop "SWAG-ing," his shorthand for "scientific wild-assed guessing."

Here he was, emotionally naked before his troops. Gone, for a moment, was the CEO on a turnaround mission. Revealed was what few Apple employees had ever seen: an elemental passion for Apple, the kind that co-founder Steven P. Jobs always wore on his

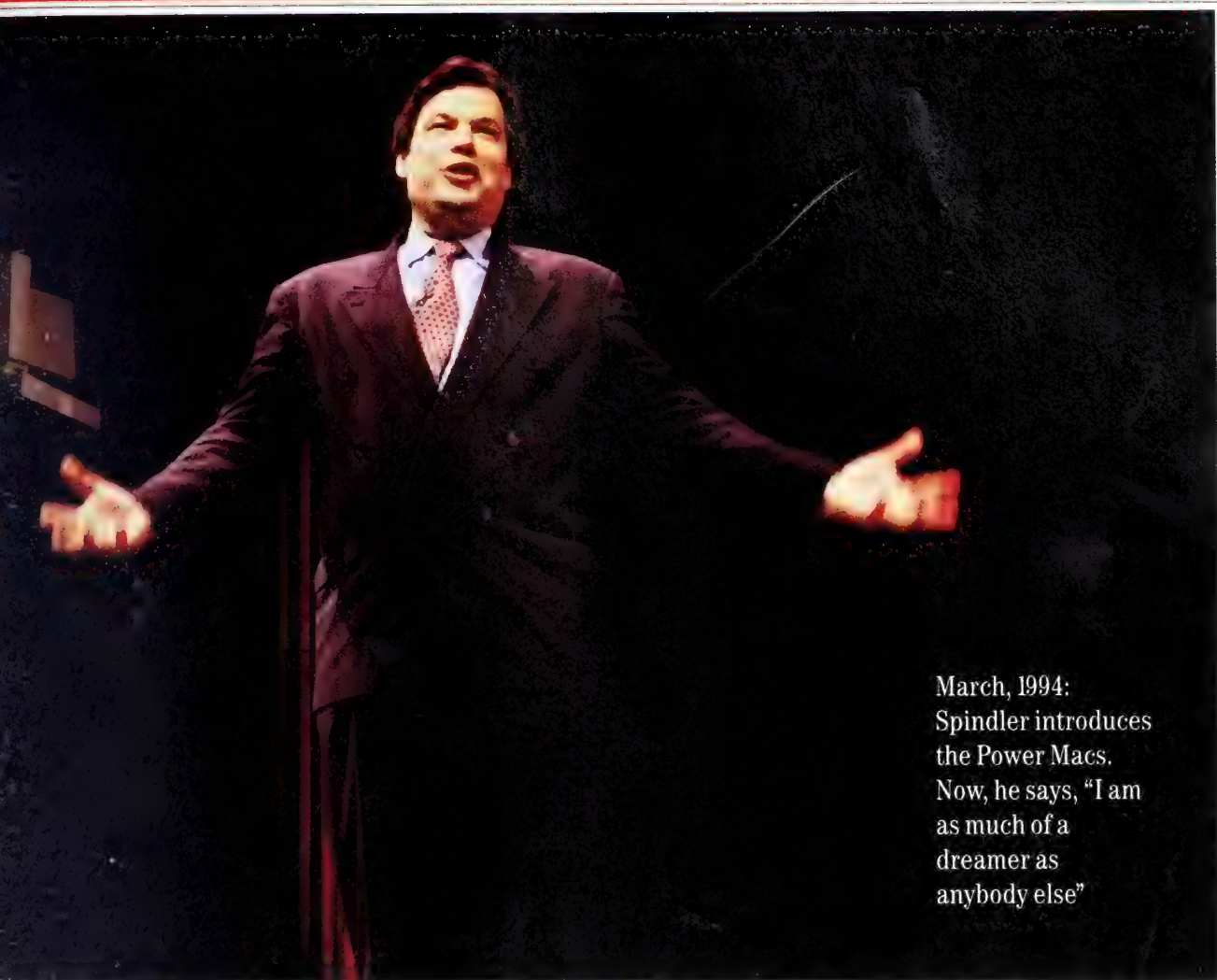
sleeve—the kind, as Apple veterans wistfully recall, that was the very source of the company's former glory.

In the year since that night in Las Vegas, there hasn't been much outside evidence of the passionate Spindler. He disdains public showboating, shuns the press, and steadfastly guards the privacy of

his Atherton (Calif.) home life with his French wife and three children.

But Spindler the fixer has been everywhere. He has slashed costs, rationalized product lines, successfully launched the first all-new Macintoshes in a decade.

**"This
is not a
debating
society"**



March, 1994:
Spindler introduces
the Power Macs.
Now, he says, "I am
as much of a
dreamer as
anybody else"

even repaired Apple's image after humiliating experience with the overpriced but disappointing Newton hand-computer. He has new procedures for everything from getting a product approved to running a board meeting.

Apple now matches its peers on cost and efficiency. Quarterly earnings are approaching pre-crisis levels, and Apple's stock is finally out of the basement, trading around \$35. That's up from its 52-week low of \$22 but a long way from the high of \$69 some 18 months ago. For the year ending Sept. 30, it is expected to report a 13% revenue gain and earnings double 1993 levels. "Apple is certainly on the uptick, but the term," says analyst Bruce Lupatkin of Hambrecht & Quist Inc. "But longer term, there are real issues here."

MARGINALIZED. The central issue: getting enough market share to ensure that Apple does not become a marginal—and therefore endangered—player in the PC market. For years, Apple's share of the worldwide market has wavered in the 10%-14% range—lately closer to 10%. And

despite Spindler's fixes, the most recent trends point in the wrong direction.

Apple's share of the U.S. market, for example, dropped from 14.2% last year to 10.8% in the first half of this year, according to market researcher Dataquest Inc. In the red-hot home-computer market—long a Mac stronghold—Apple is in danger of losing the lead to Compaq Computer Corp. or Packard Bell. And in overall sales, Compaq is expected to dislodge Apple as the world's No. 2, behind IBM. For the 12 months ending Dec. 31, Hambrecht & Quist figures the Houston PC maker will hit \$10.5 billion, vs. Apple's \$9.4 billion.

That slippage could spell trouble. Without sufficient market share, Apple machines will not attract the software to spur future sales. The most disturbing sign so far: During the second quarter,

sales of applications programs for computers running Microsoft Corp.'s Windows software grew 55.2%, to \$1.05 billion, while sales of Mac applications rose 9.5%, to \$276 million, according to the Software Publishers Assn. In a market that grew 16.2%, Apple fell behind. And where software leads, hardware follows.

It will take all of Spindler's passion and smarts to reverse this situation. Around Apple's Cupertino (Calif.) campus, Spindler's executives talk of a simple formula: Double the worldwide market share for the Macintosh "platform"—Apple machines and clones—to 20% with-

in five years. The first five points will come from upping Apple's output, to gain 1% of share in each of the next five years, says Ian W. Diery, executive vice-president and general manager of the Personal Computer Div. The rest is

**"Pick up a
shovel, or get
out of the
way"**

IN SEARCH OF THE INNOVATIVE EDGE

Apple cut development money by nearly 25%, but it's still a hefty chunk of the budget—nearly triple the amount Compaq will spend this year



expected to come from the first-ever Mac clones.

Can it be done? Analysts say Apple has a shot at rebounding to its 14% peak—if it can stay on top where it's strong, while aggressively expanding where it's not. It's biggest lead is in education, where it reigns with a 28% share (charts). But that's only a small sliver of the industry. Apple's next-best market is home PCs, and that's where the potential is greatest. The home market is expected to double in four years. So if Apple can hold its own against surging rivals, it will automatically boost its worldwide market share. Apple's biggest weakness remains in the biggest market: Macs account for just 5.8% of sales to businesses (page 94).

NO ROOM FOR ERROR. Even if it succeeds in all these markets, Apple still has to build a huge clone business to hit the magic 20% goal. Starting from zero now, Apple will have to bring forth an industry with annual revenues in the neighborhood of \$6 billion five years from now. This is the longest long shot in Apple's strategy. While the company spent years debating internally the idea of licensing to clonemakers, the Micro-

soft Windows juggernaut swept the industry. Apple finally outlined its licensing plan in mid-September, but in trying to protect its own revenues may wind up without the licensees who could sell the most Macs. Leading PC makers already have passed on the offer, leaving Apple's best hopes in Asia, where Windows doesn't yet dominate. "Apple can go toe-to-toe with Windows in Asia," says Michael K. Kwatinetz of PaineWebber. "That battle isn't over."

All in all, Apple has set a hugely ambitious course. And this time, even the most gung-ho insiders concede, any recurrence of the sudden fumbles that have dogged Apple in the past could be fatal. Says Chief Financial Officer Joseph A. Graziano: "We don't have any room for error in any respect."

That's for sure. The Power Macs, based on the speedy Motorola-IBM PowerPC chip, have given Apple hardware that can match the best in price and per-

formance. But Apple's easy-to-use software—what made it a standout in 1984—isn't so special now. Microsoft Corp. Mac-aping Windows has more than 80% of the market. And its Windows95, due next spring, is shaping up to be an "Apple killer." Says a former Apple executive: "I have always been an Apple zealot. But after seeing [Windows 95], I can be one any more. What have they got going for them? I don't get it."

One answer is Spindler. In his 11-month tenure in the top job, he has used his leadership to get the notoriously scattered Apple culture to focus on goals—and achieve them. With the new Power Macs, for example, he has steered the company through the first stages of a tricky transition to a new hardware "architecture." Sales took off, then stalled, and are now steady—putting Apple on track for reaching its goal: 1 million Power Macs in the first 12 months. "He's the right man at the right time," says Apple director Bernard Goldstein. "Michael is a superb hands-on administrator."

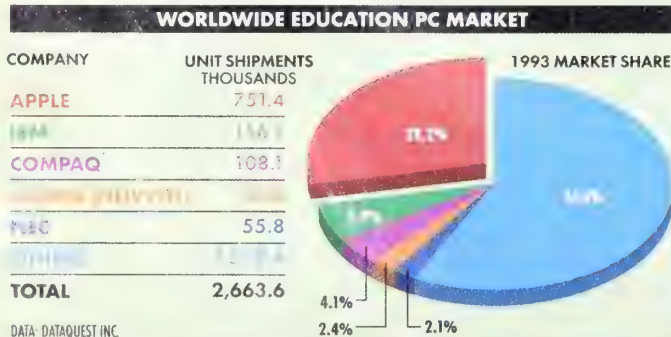
By the time he made his fateful 15-minute decision last summer, he had proved that many times over during his 11-year climb at Apple. Recruited from Intel Corp. in 1980, Spindler rose through various sales jobs to become head of Apple's European business in 1987. Within two years, he had doubled sales. Brought to Cupertino as chief operating officer in 1990, Spindler quickly masterminded Apple's first foray in low-cost computers, the Mac Classics.

Today, Spindler has left his mark on every nook and cranny of Apple. He started by laying off 2,500 workers, ca-

"Don't throw technology over the wall"

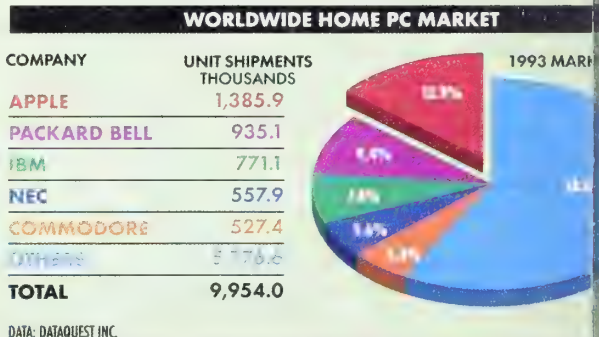
THE MAC IS STILL TEACHER'S PET...

Despite an assault by IBM and Compaq on the education market, the Apple brand still retains a commanding lead.



...AND THE TOP BRAND AT HOME

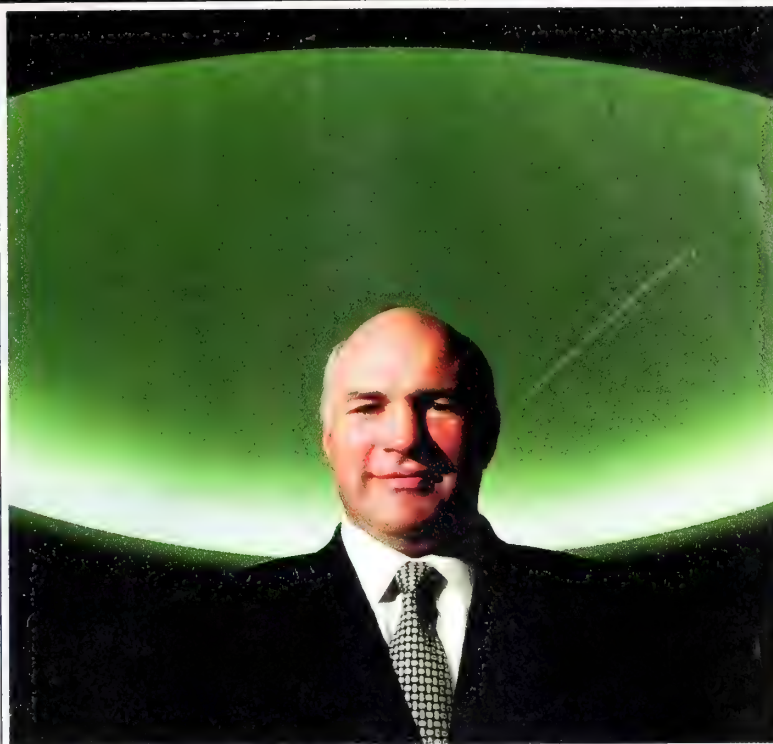
Competitors, particularly Compaq and Packard Bell, are closing on Apple's lead in 1994, but consumers still like Apple.



blue-sky projects, increasing research and development costs by more than \$100 million a year, increasing executive salaries and even taking the company to sacred perks—day-care and fitness centers. Gone too, are \$1,000 funds for imminent “creative projects.” In short, Apple finally gotten serious. “Mike knows Apple is vulnerable and not in the woods,” says a public-relations guru, John McKenna, a friend of Spindler’s and Apple’s final image-maker. “He has come in with the view this is a cold, hard, cruel world, and there are no guarantees.” Now Apple has a business model that lets it compete head-on with the likes of Compaq and Computer Corp. Apple matches them on price and can turn profits on gross margins of 26%, down from 40% just 18 months ago.

Still, simply keeping up will eventually mean falling behind for Apple. Why? Because Apple, unlike its PC competitors, must fund development of its own software, a costly proposition. Even slashing R&D budgets, Apple spends up to eight times what Compaq and Dell shell out for research and development (chart). But Spindler can’t afford to cut: His only hope in achieving his market-share goals is to restore the kind of differentiation between the Mac and competition that generated such excitement a decade ago—and enabled Apple to charge prices that could support its lavish R&D machine.

An engineer by training, Spindler is a



Window of opportunity: Diery sees a “Wintel rupture” coming

self-confessed “techie.” But he’s not likely to become Apple’s third CEO/techno-philosopher-in-residence. The headquarters long ago was dubbed the Crystal Palace for the lofty visions spun there. Jobs was the first dream maker, who talked of “insanely great” products. Sculley started as a marketing whiz, but became a self-styled techno-visionary, too. **NERDS OF A FEATHER.** Vision is out of style—at least this season. “It’s easy to have lots of vision with 50% gross margins,” says Michael Mace, Apple’s manager of competitive analysis. With 26% margins, substance is vital. “With Mike, you get a lot of steak. You’re not getting a lot of sizzle,” says Floyd E. Kvamme, a venture capitalist who was once Spindler’s boss at Apple. “There’s a lot of steak, though.”

Which is fine with the T-shirt and tennis-shoe crowd that develops Apple’s technology. “With Spindler, it’s like talking with another nerd. He gets it,” says Steve P. Capps, an Apple Fellow, a top engineering designation. “I think we had too much vision with Sculley—all those speeches and trillion-dollar markets.”

Throughout Apple, Spindler keeps the focus on the next few critical years, not the distant future. At staff meetings, he can be seen at the whiteboard, scrawling his strategies in step-by-step charts, diagrams, and outlines. “Rembrandts—they’re so well thought out,” says one executive. Spindler’s old nickname, Diesel, has given way to a new one: the Firehose. “It is a workout to be in a meeting with that man,” says Mace. “He goes a mile a minute, and the ideas pour out of him.”

Spindler didn’t just start spouting ideas, either. Insiders say he was the first to warn that the Mac was running out of steam and insisted that Apple switch to the PowerPC architecture. He was the first to broach the idea of teaming up with IBM in what became a far-ranging partnership. Says former IBM President Jack Kuehler, who spent months in 1991 negotiating that deal with Spindler: “He can be creative or pragmatic. I don’t think the world has given him that credit.” Just try to pigeonhole Spindler as simply a deft manager, and he erupts: “Meat and potatoes and nuts and bolts. Bull . . .!” he says, pounding the small, round table

BUSINESS REMAINS INDIFFERENT... ...AND APPLE IS FAR FROM ITS GOAL

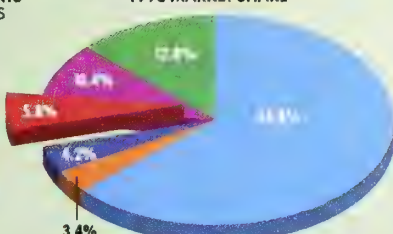
Business may be hip to Apple, but business executives just don’t get it. The information officers prefer the IBM PC standard.

To ensure its position as a major player, Apple executives say the company needs 20% of the world market—including clones. They’re only halfway there

WORLDWIDE BUSINESS PC MARKET

UNIT SHIPMENTS THOUSANDS
3,012.6
2,454.7
1,372.8
983.1
821.1
1,500.1
23,544.6

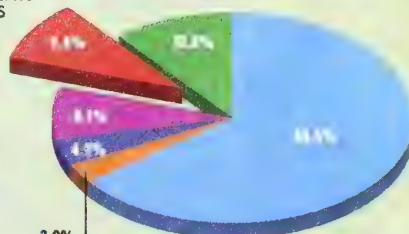
1993 MARKET SHARE



WORLDWIDE 1993 SHIPMENTS

COMPANY	UNIT SHIPMENTS MILLIONS
IBM	4.2
APPLE	3.7
COMPAQ	3.1
NEC	1.6
DELL	1.2
HP	25.0
TOTAL	38.8

1993 MARKET SHARE



DATA: DATAQUEST INC.

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in his office. "I am as much of a dreamer as anybody else."

For now, however, it's the meat-and-potatoes issues that count. He has set down a simple road map—what he calls his "Strategic Front End"—for employees to follow. There are key applications for the Macintosh (publishing, learning, technical, and communications) and key mar-

but like so many debates at Apple, it led nowhere. "Apple has this culture where the vote can be 13,000 to 1 and still a tie," says Roger Heinen, a former Apple executive who is now a senior vice-president at Microsoft.

Early in his tenure, Spindler ended the debate, but it still took seven months to come up with a plan. The

idea now is a "phased" approach, under which Apple will initially select three to six licensees that "complement" rather than compete with Apple in major markets. Broad licensing may not happen for another two to three years.

So far, no takers have been identified. But insiders say talks are progressing with Toshiba,

Olivetti, Motorola, and Germany's Vobis Microcomputer, which together scratched out 4.6% of the PC market last year. The big prize would be IBM, which Apple continues to negotiate with. But talks have been deadlocked over IBM's demand that Apple agree to a common hardware platform for both

companies' PowerPC-based machine.

Spindler says the measured approach was the only way to protect Apple revenues and earnings. "We could shoot ourselves in the foot and put our entire business at risk," he says—the way IBM let clones overwhelm it. That's missing the point, says Aaron Goldberg, president of Computer Intelligence InfoCorp. "They don't get it. Licensing is like pregnancy. You either do it all the way or you don't. Deep in their hearts, they think they can't compete so they don't want to license to anyone big."

"BUSINESS 101." As Spindler wrestles with ways to preserve profits while boosting the Macintosh market share, he hasn't entirely given up on Sculley's vision to take Apple into new markets. He has, however, brought it down to earth. Take Apple's Newton. A marketing and public-relations fiasco, it gobled up \$100 million in R&D costs, but still couldn't perform the handwriting recognition that was key to its usefulness. Just 90,000 units were sold in the first 10 months, way short of the 150,000 that analysts expected. But Spindler says Newton will succeed—reborn as a business tool, rather than the mass-market consumer gadget Sculley envisioned.

"Repetition does not spoil the prayer"

kets (education, small and large business, the home). The near-term game plan calls for new models, the biggest ad blitz since the Mac launch in 1984, a sharper focus on customers, and white-hot heat to finish Copland, software that will be Apple's answer to Windows 95. Says up Daniel Eilers, president and CEO of Claris Corp., Apple's software subsidiary: "Michael is trying to move Apple from the insanely great products company to the sanely great company."

But is he too cautious? Take Spindler's approach to licensing. Apple started seriously debating the pros and cons of licensing Macintosh clones in 1986,

A HUMBLER APPLE TRIES SQUEEZING INTO PINSTripES

What a load of frustration. For a decade, James B. McLaughlin, director of research and development for Bergen Brunswick Corp., had been trying to get Apple Computer Inc. to sell him Macintoshes his way. When he wanted a special hardware configuration that wasn't on computer-store shelves, Apple said forget it. The company didn't cater.

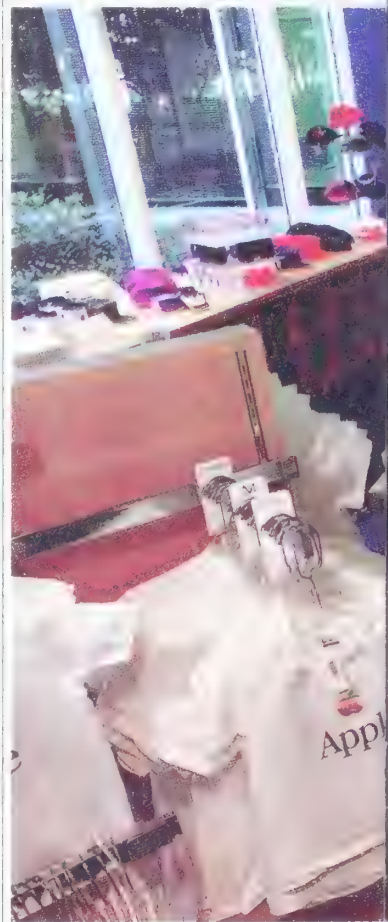
Not, that is, until this year. When McLaughlin came knocking, asking for a custom Mac for the Orange (Calif.) distributor of health-care products to provide to pharmacies, Apple went on alert. A meeting with Chief Executive Officer Michael Spindler was arranged and, after a 10-minute discussion, a deal was done.

Apple would break its old rules and adapt a Macintosh created for the school market for McLaughlin's needs. Pharmacists would use these to manage their businesses and track stock and purchasing patterns. Bergen Brunswick ordered 5,000. Says McLaughlin: "Today, Apple is right in there, scrapping with the other computer companies. I don't know if

there was a humbling or what, but they changed."

Humbled? You bet. Changed? Apple is working on it. When Apple's sales stalled in the summer of 1993, the company didn't just change CEOs, it completely changed its attitude. Spindler is, as he likes to say, the first CEO at Apple who started there "carrying a sales bag." Little wonder, then, that he is turning up the heat to win over business customers.

AVON CULLING. The question is, of course, whether Apple stands a chance. Yes, but it will be a hard slog. Beefing up its presence in the corporate arena is undoubtedly the toughest element in Spindler's turnaround plan. In addition to Bergen Brunswick, the company claims some recent conquests, including Booz, Allen & Hamilton, Cornish & Carey Residential, and Trisim, a Fort Worth trucker. But gaining enough converts to lift its share of the business market significantly looks iffy. Sporadic and ineffective efforts over a decade have left the Macintosh with just 5.8% of the business market, not enough to excite software writers. Now, the Mac is behind in



Spindler says he tried to delay Newton until the software was ready and to focus on niches such as field sales. "I don't want to discuss internally at the time," he says. "But I can't turn it back." Spindler is also keeping other long-term projects alive. He says he can see when Apple will be into TV set-top boxes, videoconferencing, and video games. But in a departure from the past, Apple, he says he's not ready to go into detail. "I want to make it work first before we go brag about it. There's that pragmatic streak again. That attitude is summed up in a dozen phrases that pepper his conversations: "Pick up a shovel, or get out of the way," or "Are you part of the problem or part of the solution?" and "Apple is not a debating society."

For now it is a free-for-all anymore. Unlike predecessors, Spindler is a stickler for process. He has instituted the Apple Product Process, which requires five phases of rigorous review—concept investigation—before any project gets the green light. Even board meetings have been overhauled. Spindler led his staff to compare Apple's meetings with those of six "world-class" companies, including Johnson & Johnson, Coca-Cola, and Motorola. Now, at the end of each meeting, there is a "strate-

gic framework" discussion, with charts and graphs showing changes since the group last met. Sound basic? It is. Says Kevin J. Sullivan, vice-president for human resources: "Michael, in many ways, is about Business 101."

Spindler has been teaching a special crash course to the all-important Mac division, which he felt lacked discipline and focus. All development projects have been scrutinized and priorities set. Questionable projects—what Apple execs call "electronic ashtrays"—were given the boot. The goners: Sweet Pea, a portable multimedia player; Scout, a low-end Mac using an old Motorola chip; and Bic, a larger-screen Newton. "The wrong behavior here was we just did great technology, put it in a product, and then let the customer find out whether it was or not," says Spindler.

The boss also wants better work from marketing and operations staffs—in forecasting demand, tracking supplies, keeping tabs on what's selling and what's not, and keeping a vigilant eye on rivals.

APPLE'S STEADY CLIMB BACK



Predictability in delivering and managing products is so essential that Spindler pledged to the board that 50% of his 1994 annual compensation would be pegged to getting it done right. That's no wee gesture, considering his 1993 salary and bonus of \$999,087. "If it doesn't happen, I have one pocket empty," Spindler told his employees.

Leaving nothing to chance, Spindler has revived "war rooms," a

system he used to launch the bargain-basement Mac Classics four years ago. Today, a conference room labeled "Imagination" is devoted to the challenge du jour. In the past year, there has been a Power Mac war room and one to drum up Power Mac software. The biggie now is the Windows 95 war room, where hardware, software, manufacturing, sales, and marketing commandos meet to plot measures to head off the enemy.

"We're starting to fire on all cylinders. This is the first time in a long time. This is heaven," says the PC division's Diery. In addition to the Power

client/server programs, a must in corporate computing. "We're using some applications that don't exist for the Mac," says Andre Razzino, a manager of PCs and networks for Avon Products Inc.

Sounds grim. But Apple isn't daunted. Its ambition: to increase its share of the \$46 billion worldwide business market to 15% in the next five years. Power Macs, the first Macs in years that can compete on price and performance, are a start. On top of that, Apple is increasing its national sales force and has gotten PowerSoft and SAP to adapt their client/server software for Macs. "The good news is our momentum is building," says James J. Buckley, president of Apple USA. "We're seeing some general acceptance of Power Mac in the large account space."

It will take a tractor-trailer full of momentum—and more—to make a dent in a market that has 13 years and billions of dollars invested in software for computers using Intel Corp.'s microprocessors and Microsoft Corp.'s operating-system software. "When Corporate America looks at all the agony it would have to go through to switch, it's just not worth it," says Martin Reynolds of Computer Intelligence InfoCorp.

"Our momentum is building," says Buckley

Apple argues that it now has the products, the prices, and the attitude to make buying Macs a worthwhile choice for business. To convince buyers from top companies, it plans to bring 1,200 of them to Apple's briefing center this year to inspect the company's wares and listen to proposed solutions for their information-technology needs.

"AGE-OLD STORY." Most important, Apple is no longer asking customers to scrap all that IBM PC software. Power Macs will fit into the corporation by running the software that's already there—as well as the Mac's own programs. Today, it's done through a program called SoftWindows. It runs applications written for Microsoft Windows, although at a slower pace than programs written for the Power Mac. In November, the company will unveil "Houdini," an add-in card for Power Macs that packs an Intel 486-compatible microprocessor.

To the skeptics, it doesn't much matter what Apple says now. "Apple's push into Corporate America is an age-old story," says analyst William M. Bluestein of Forrester Research Inc. "And it's not been a good one." Apple will have to turn around a lot more customers like Bergen Brunswig before it can write a happy ending.

By Kathy Rebello in Cupertino, with Paul Eng in New York



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Cover Story

Mac's, there are new laptops and home models including the Performa 630, multimedia machine starting at \$1,499 that can display TV shows in an on-screen window. In October, Apple plans Performas using the PowerPC chip.

Apple's even feeling a bit of its own cockiness. Company executives now say they see their chance to undermine the powerful combination of Microsoft Windows and Intel Corp.—which Spindler lumps together as "Wintel." Diery predicts a coming "Wintel rupture," where Intel's chip design runs out of oomph and Intel is forced to switch to a pure RISC (reduced instruction-set computing) design similar to the PowerPC. When that happens, he says, Microsoft will be forced to redo Windows—potential creating compatibility problems with existing Windows programs.

"BLUFF, BLUFF, BLUFF." Fat chance, says Microsoft. "There's no performance or price-performance reason to switch [to RISC]," says Brad A. Silverberg, a Microsoft vice-president overseeing the development of Windows 95. Apple's claim of trouble looming in the Wintel camp is nothing but whistling past the graveyard. Says Silverberg: "If there's one hand left to play, and you're dealt a pair of deuces, you're going to bluff, bluff, bluff."

For Apple's part, it says it has a ace up its sleeve: Power Macs are getting better at running Windows software—offering customers the best of both worlds. At first, this was done slowly—with a software program. This fall, there will be an add-in card, code-named Houdini, that will literally give the Mac an Intel 486-class PC.

The computer-with-two-brains approach may appeal to consumers who want a Mac for the kids' education programs and a PC for Mom's spreadsheet. But will it prompt business customers, the key stronghold of the Wintel gang, to give the Mac a second look? Not unless the Mac starts attracting better business software. "The Mac is not a good mainstream solution because it's not the first choice for any vendors to write software for," says Pompei, manager of information systems at Brewers Retail Inc., in Mississauga, Canada. And that may not change until Mac's market share rises.

Which poses the kind of Catch-22 that might prompt some executives to harden their heads and head for a cozy retirement in the tomato field. For Michael Spindler, it's another challenge to overcome in the fight to preserve his beloved Apple.

By Kathy Rebellio in Cupertino, Calif., with Ira Sager in New York and Richard Brandt in San Francisco

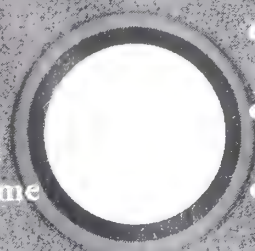
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Dotson, Mr. Richard Stephen Kane, and Mr.
Victor Weiger, the 1994 Business Week/ATD Truck
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Mr. Terry L. Dotson
**1994 TRUCK DEALER
OF THE YEAR**
FINALIST



Mr. Richard Stephen Kane
**1994 TRUCK DEALER
OF THE YEAR**
FINALIST



Mr. Victor Weiger
**1994 TRUCK DEALER
OF THE YEAR**
FINALIST

BusinessWeek

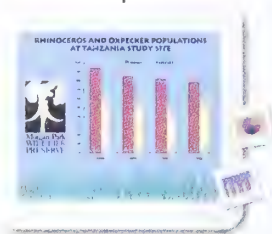
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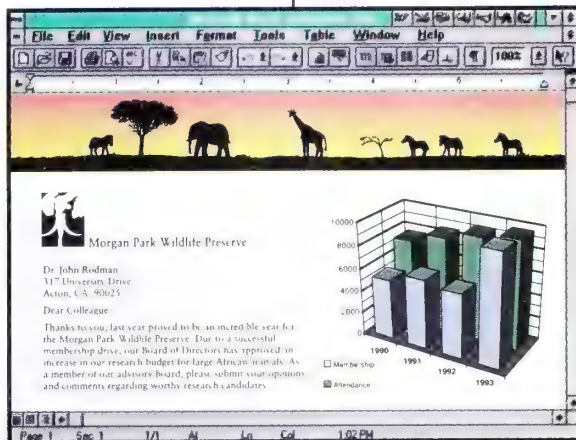
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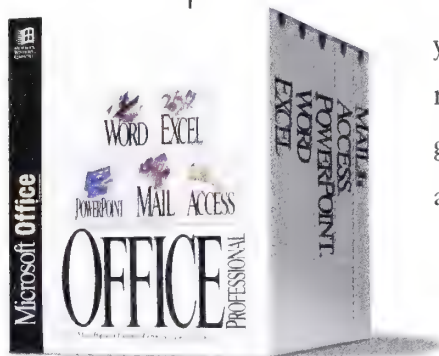
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FINANCING WORLD

After countless false starts, the elusive global economic recovery has arrived. No longer is the U.S. the Little Engine That Could, laboring to pull the other major economies out of recession. In Europe, thanks in part to strong exports to the U.S., most nations are aboard the expansion train, with average growth projected to hit 2.7% this year and next. And recovery is apparent even in Japan, where 6.2 trillion yen worth of tax cuts are helping to revive an economy derailed by financial and real estate problems.

Throw in continuing explosive growth among the major developing nations, plus slow but steady progress in the former communist states, and you get an expansion that could be the broadest-

based in decades. "The next couple of years should be stellar—and with the help of countries that were never even on the radar screen before," says Allen L. Sinai, chief economist at Lehman Brothers Global Economic Advisers Inc. **TRIPLE DIP.** Yet beneath the euphoria lies a nagging question: Is there enough capital to satisfy the tremendous demand? Combined, the global appetite seems staggering. The developing nations of Latin America and East Asia, eager to build their new market economies, are sucking in more than \$140 billion annually—triple the amount of capital they absorbed in the late 1980s.

Meanwhile, the formerly communist nations of Eastern and central Europe are ravenous, laboring since the fall of the Berlin Wall in 1989 to produce an attractive investment environment. According to Columbia University projections, the region could easily absorb up to \$500 billion. Yet J.P. Morgan & Co. economist Susanne Gahler estimates that Eastern Europe will receive only \$5.52 billion in total net direct and portfolio investments in 1995.

Even in Western Europe, a push by governments to privatize such state-owned corporations as Renault could create an additional \$100 billion in capital needs in the next five years. "The world

POLAND

PRIVATIZING

Boston's Pioneer Group is organizing a \$50 million venture fund to take stakes in Polish companies

SCARING UP THE CAPITAL

Often with the assistance of seasoned players from the industrial nations, borrowers in the developing economies are finding creative ways to raise the funds needed to keep growing and deliver competitive returns

HUNGARY

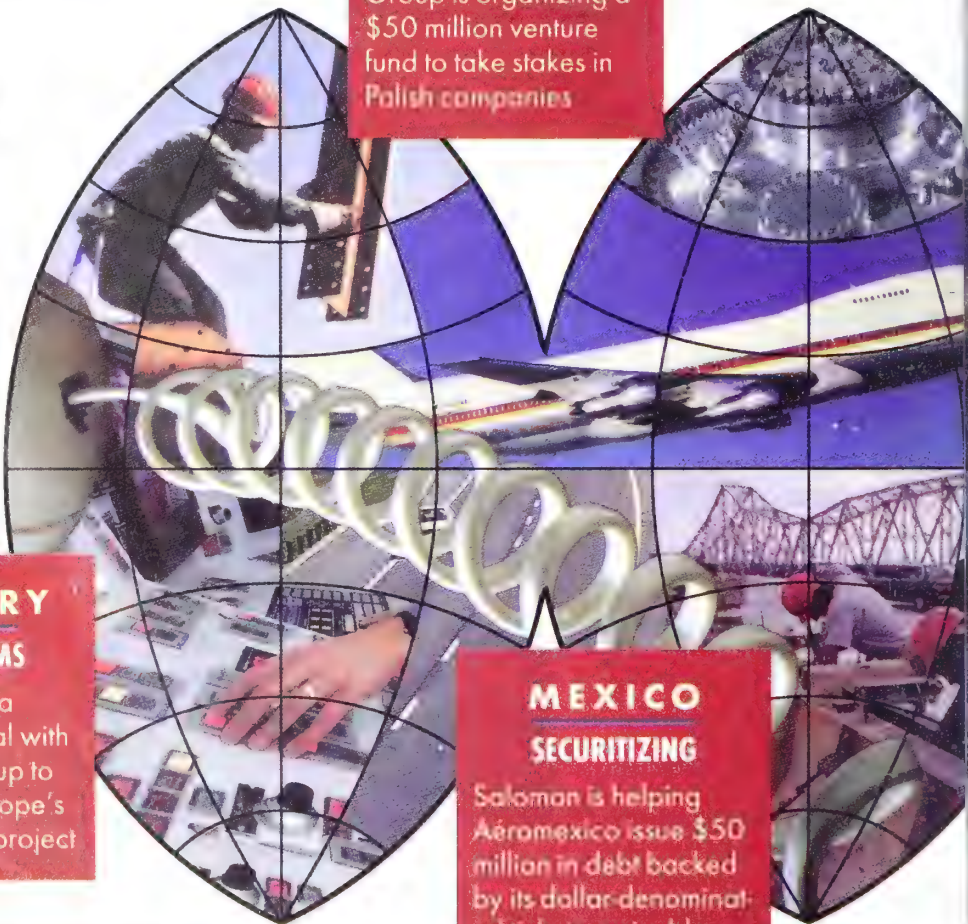
CONSORTIUMS

Hungary signed a \$350 million deal with a French-led group to build Eastern Europe's largest toll-road project

MEXICO

SECURITIZING

Saloman is helping Aeromexico issue \$50 million in debt backed by its dollar-denominated ticket receivables



GROWTH

AS GLOBAL ECONOMIES BOOM, LENDERS ARE SCRAMBLING TO FEED THEIR NEED FOR CASH

ing an accelerating demand for capital that is unprecedented, particularly infrastructure projects," says Win H. Smith Jr., head of international operations for Merrill Lynch & Co. aggravating the potential squeeze is the virtual disappearance of Japanese investors from the global stage. After playing a leading role as a world financier during the 1980s, Japan remains in a virtual state of hibernation, focusing on repairing its ailing financial system. While borrowing requirements from the rest of the world have doubled since 1991, the outflows of short-term capital

from Japan have shrunk to just one-tenth of their 1980s peak of \$137 billion, according to Merrill Lynch.

As a result, some market watchers predict that the intense competition for capital will result in higher interest rates and increased currency volatility as investment demand outstrips the global supply of excess savings. Currency swings have even prompted calls for a return to more closely regulated markets (page 108). "We've never seen more

potential business in all four corners of the earth, all wanting to access the capital markets," says John M. Hennessy, chief executive of CS First Boston. "Projects that don't have high returns may be sliced off, and

many of those may be in the industrial countries." Global superinvestor George Soros opines that capital will increasingly go into what he calls "the real economy" rather than financial assets (page 104).

CASH HOARDS. Interest rates are already heading north in several major economies, from the U.S.—where the Federal Reserve has ratcheted up short-term rates steadily since early this year—to Europe, where Sweden, Italy, and most recently Britain have raised their benchmark rates. With inflation at a low ebb in the industrialized nations, real 30-year interest rates in the next year could rise to 4.5%-5% in the U.S. and above 6% in Europe, predicts Lehman's Sinai—"the upper end of historical averages," he notes.

Despite the relatively high cost of borrowing, many experts dismiss any

notion of a global capital shortage. European and U.S. corporations are sitting on substantial cash hoards, and the developing world is gradually becoming less dependent on industrial nations for external financing. East Asian nations such as China have

savings rates of about 30% of gross domestic product vs. about 19% in the major industrial countries. As developing nations such as Brazil, China, and Russia reduce inflation, the resulting drop in prices pushes up consumers' purchasing power—so that less capital is needed to generate the same output. Lower inflation also strengthens these countries' currencies, boosting local savings and prompting wealthier investors to reimport "flight capital" from safe havens such as the U.S.

Indeed, what distinguishes the current global recovery from past expansions is the remarkably unhindered flow of investment funds circling the globe in search of the best return. Investors are

VIETNAM

MUTUAL FUNDS

Franklin Resources launches the \$98 million Templeton Vietnam Opportunities Fund—the fourth such fund

PHILIPPINES

RISK MANAGEMENT

National Power raises \$100 million in 15-year bonds with a "put option" guarantee and a 9.75% coupon

RUSSIA

T-BILLS

A one-year-old, \$2.7 billion market in short-term Treasury debt is flourishing, with longer-term bonds planned



putting together deals that would have been unthinkable just a few years ago. Some examples:

■ Bankers are lending to borrowers that haven't achieved investment-grade status by tying the financing to specific projects or revenue sources. In June, for instance, Salomon Brothers Inc.

raised \$50 million for Aéromexico in a private placement of five-year bonds securitized by the Mexican airline's dollar-denominated ticket receivables. Similarly, in July, the National Commercial Bank (Jamaica) Ltd. borrowed \$65 million in a debt issue backed by credit-card receivables.

■ The mutual-fund industry, that bastion of democratized capital, is planting flags in previously untapped markets. On Sept. 15, Franklin Resources Inc. launched the \$98 million Templeton Vietnam Opportunities Fund Inc.—the fourth Vietnam fund now trading. Combined, investors have pumped more than \$240 million into a country that still doesn't have an organized stock exchange.

■ With the help of experienced capitalists, new free-market economies are rapidly developing their own capital markets. In a room near Moscow's Gorky

BASICS The developing nations' infrastructure tab could hit \$1 trillion over the next decade

Park, traders gather for two hours each day to buy and sell three- and six-month Russian securities auctioned by the government—already a \$2.75 billion market. Buoyed by the success of these auctions and by the nation's recent progress in taming hyperinflation, the Russian central bank will soon

begin selling one-year bills out of its regional offices at preset prices.

Worldwide, the pool of funds racing around the globe is growing. Around \$1.5 trillion is now held in dedicated international-equity portfolios. A further \$50 billion to \$100 billion resides in discretionary accounts run by hedge-fund managers who just this year jumped in and out of such volatile investments as Chinese government bonds, Brazilian coffee futures, and Turkish stocks.

Even U.S. and European pension funds, traditionally cautious investors, are eyeing exotic shores. Overseas opportunities are expected to play a growing role in meeting their steep funding obligations in coming years as returns from developing-country investments surpass those closer to home. John Webster, a partner at consultant Greenwich Associates, expects U.S. pension manag-

ers to boost their share of foreign assets from 8% to 12% by 1996.

Likewise, insurance funds' interest in international investing should increase as more developing nations secure "investment-grade" status from at least half the four major U.S. rating agencies, a requirement set by the National Association of Insurance Commissioners. Jer F.H. Purcell, Salomon's managing director of emerging markets research, predicts that Mexico, India, and Hungary could all secure investment-grade ratings from two agencies as soon as next year, which will attract new investors. "As soon as the NAIC restrictions are lifted in more countries, insurance companies are going to become major players in developing markets," predicts Purcell.

If the competition for capital proves too rough despite these new sources of funds, governments may be largely to blame. Years of profligate public spending in the major economies, together with declines in private savings rates, have driven government debt levels to historic highs. Yet there are few signs that nations' borrowing needs will diminish significantly, even if the global boom increases tax revenues. The rigid social mandates of most Western European governments should conspire to

the 1995 deficits for the Continent stubbornly high 5% of gross domestic product, vs. 1.8% in the U.S. Those high deficits are already creating anxiety in the markets. Interest-rate bids on 10-year bonds issued by high-rated countries, such as Germany, lower-rated ones, such as Italy, have risen to more than 4.5 percentage points. European governments have been delaying debt issues and pushing out funding schedules; Germany and France, for instance, shelved bond issues this summer. That only heightens the mood of a logjam next year, when private borrowing is expected to pick up. Some European financiers are even beginning to fret that higher rates could choke the Continent's nascent expansion. "I think we can sustain recovery with real interest rates in the ranges we have today, but not much more," says André Lévy-Lang, management director and chairman at Compagnie Financière de Paribas, one of France's largest investment banks.

Of course, the scramble for capital is an opportunity for Lévy-Lang and other money merchants, who are working overtime to satisfy global demand. The current mood is bringing many development-borrowers back into the markets for the first time in years. The governments of Hungary, India, and the Czech Republic all recently returned to the bond market for the first time since 1989, and South Africa is preparing its reentry. "There has to be more willingness to do speculative-grade debt in the bond market," says George Stans, managing director of Standard & Poor's Corp.'s European operations.

Bankers are also taking imaginative risks with developing nations that don't qualify as borrowers based on traditional standards. Financing techniques were once confined to industrialized nations, such as securitizations and asset-backed financings, are increasingly becoming popular elsewhere. For example, the Hungarian government recently signed a \$350 million contract with a French-led foreign investment group to build the largest toll-road project in eastern Europe.

Another trend is taking shape in countries with new or small stock markets. With foreign funds sometimes overwhelming the equity markets of developing nations—witness Latin America last year—investors are seeking

Salomon thinks Hungary, India, and Mexico could be "investment-grade" by next year

stakes in private companies that may go public in the future. In Eastern Europe, where the equity markets remain small and illiquid, several firms are launching venture-capital funds to hunt for unlisted small and midsize companies. After establishing the first—and only—Polish mutual fund, Boston-based Pioneer Group Inc. is organizing a \$50 million institutional venture fund designed to take private stakes in companies in Poland.

Likewise, Central Europe Trust, a London-based advisory firm, aims to raise up to \$200 million for a family of development capital funds that will target small companies in Poland, Hungary, the Czech Republic, and Slovakia. "We want to avoid overpriced stocks that are at the mercy of the wall of money from huge Western investment houses,"

says Tom Lampl, managing director of Central Europe Trust.

Still, the need among developing nations for infrastructure, from ports to power plants, is immense: Some estimates put the total tab for the next decade at \$1 trillion. That could overwhelm the bond markets, particularly for countries that are years from reaching investment-grade status. "You can't pay for a power plant with the seven- or eight-year financing most banks offer," says Anthony R. H. Bottrill, deputy managing director of the Washington-based Institute of International Finance.

BENCHMARK. So financiers must find ways to help developing nations build bond markets that stretch maturities. The World Bank recently provided an unusual "put option" that guarantees investors the full return of principal at maturity of a 15-year bond issued by a Philippine utility, National Power Corp. With this guarantee in hand, Morgan Stanley & Co. and Salomon Brothers were able to raise \$100 million at a rate close to that of another National Power obligation, a 10-year note backed by the Philippine government. "You establish a benchmark so markets can start making their own judgments," says Gary L. Perlin, the World Bank's director of financial-sector development.

The pace at which capitalism has rolled through developing economies is breathtaking. It's easy to forget that as recently as a decade ago, only 1 billion of the world's citizens were playing by capitalist rules. Today, three times that number have been brought into the game. No wonder there's an unprecedented demand for money. But with optimism spreading about the prospects for the global economy and creative solutions taking hold for overcoming investment barriers, lenders and borrowers from London to Lima are finding that they can do business with each other.

By Dean Foust in Washington, with Karen Lowry Miller in Bonn, Bill Javetski in Paris, and bureau reports

AS WORLD ECONOMIES RECOVER...

	Annual GDP growth rates, in percent		
	1993	1994*	1995*
EUROPE	-0.5%	2.7%	2.7%
U.S.	3.0	2.6	3.1
JAPAN	0.1	0.8	1.1
NON-JAPAN ASIA	NA	10.7	8.8
LATIN AMERICA	NA	12.8	12.6

DATA: MORGAN STANLEY & CO.

*Estimates

...INTEREST RATES CREEP UP...

	Maturity	Short- and long-term yields, in percent		
		Sept. '94	Feb. '95*	Sept. '95*
U.S.	3-month	4.89%	5.50%	6.00%
	10-year	7.23	8.00	7.75
BRITAIN	3-month	5.38	5.90	6.40
	10-year	8.51	8.40	8.50
GERMANY	3-month	4.93	4.60	4.60
	10-year	7.05	6.90	7.00
JAPAN	3-month	2.34	2.70	3.30
	10-year	4.65	5.00	5.10

DATA: MERRILL LYNCH & CO.

*Estimates

...EVEN WITH MODEST INFLATION

	Consumer prices, percent change		
	1993	1994*	1995*
EUROPE	3.1%	3.0%	3.2%
U.S.	3.0	2.7	3.2
JAPAN	1.3	0.6	0.7

DATA: CS ECONOMIC RESEARCH

*Estimates

'FOR ONCE, WE'RE ALL IN SYNC... IT'S A WORLDWIDE UPSWING'

George Soros and his chief trader, Stanley Druckenmiller, assess the world's financial future



A grin spreads across George Soros' tanned face as the legendary investor says that "amateurs like us" can't be expected to know where the world's financial markets will go this fall. Indeed, since Soros' Quantum group of funds lost \$600 million on Valentine's Day after making a wrong bet on Japan's currency, stock, and bond markets, Soros might be understandably wary of taking any risks at all right now. Yet the 64-year-old head of Soros Fund Management is hardly holding back. With financial markets establishing firmer footholds in the former communist bloc, Soros has recently begun moving cash into Russia and Eastern Europe. He has set up another fund to invest in power plants and other projects across the developing world.

Over grapefruit, pastries, and coffee in his apartment overlooking Manhattan's Central Park, Soros and his managing director and chief trader, Stanley Drucken-

miller, discussed the outlook for global markets with Assistant Managing Editor Robert J. Dowling, Senior Writer William Glasgall, and International Finance Editor Joan Warner.

Are we entering a period of rising interest rates worldwide?

SOROS: Yes. I think we are.

Does that mean the time of falling interest rates in Germany is over?

SOROS: Not necessarily. The Germans have stopped lowering rates at too high a level relative to where we are in the U.S. There is still room for one more easing action after a few months.

DRUCKENMILLER: I wouldn't agree with that. They're probably done with their

“The Federal Reserve has erred by keeping interest rates too low too long”

— GEORGE SOROS

Soros Fund Management, President

easing. They'll probably sit a while. If I had to guess, I would say that the next move would be up, not down.

Mr. Soros, last year you said the German mark was overvalued. Is that still the case?

SOROS: I said at the time that the mark was going to fall because the Bundesbank had overstayed its course of high interest rates. The economy was weak and a weak economy leads to a weak

ncy. Now, a year later, the economy in Germany is strong. In spite of the high value of the mark, exports are picking up. The U.S. economy is also strong—stronger than the German economy. The Bundesbank has gone out of its way to ensure the value of the mark by following a very restrictive policy and has erred by lowering interest rates too late and perhaps too little. The Federal Reserve has erred by keeping interest rates too low too long. You have parity on interest rates that would favor the mark and a disparity on exchange rates that would favor the dollar. Is it monetary activity or interest-rate policy? To answer the question, I would take a hard position.

Did your Japanese losses teach you anything about the currency market?

SOROS: That this is a time which is not particularly rewarding for currency speculation. The tensions that were there in the past two or three years, the imbalances that lead to large currency movements, are not currently resolved. The biggest unresolved problem is Japan—the war of words [with the U.S.] over the balance of payments surplus. We think it will be resolved, because it makes a lot of sense to resolve it. That is where we have erred since the beginning of the year. We thought it would be resolved sooner, rather than later. Funnily enough, we still think exactly the same thing.

Is the dollar undervalued against the yen?

DRUCKENMILLER: In terms of purchasing power, it is. When the Japanese economy picks up, which we think it will, and when our consumption slows down over the next year or two, that will be the biggest chance to dent the dollar's imbalance. But even then, we're going back to neutral. How undervalued can [the dollar] be if Japan continues to run surpluses?

What is your outlook for the U.S.?

DRUCKENMILLER: We just don't think short rates, with loan demand picking up, are enough to murder the economy. We seem to be having a great recovery in September. Pricing looks stronger than we read about, and volatility doesn't look bad. Housing is long on its peak, but it seems to have stabilized. It has a very long lead, and once you get it going, you don't need it [to spur growth].

Is the global recovery sustainable?

SOROS: Yes. For once, we're all in sync.

The recovery in Europe is somewhat anemic, but it's there. The [Asian] tigers and Latin America are also strong. It's a worldwide upswing. If properly managed, it could have a long way to go. You certainly won't have a straight line of growth. We could even have a bit of a growth recession. But if it's not too severe, we could have another go at the upside.

Do you see price pressures now?

DRUCKENMILLER:

There are shortages out there: chemicals, paper, aluminum, copper. I have read that wages aren't going up yet, but I'm a little bit skeptical. Until proven otherwise, I have to assume that wage pressures will kick in in the next three to six months.

Will U.S. long-term interest rates rise as high as 10%, as some have predicted?

SOROS: We don't rule that out, but we don't think it's a realistic prospect. Financial markets have an allergic reaction to inflation. It's more conceivable that the long bonds would go to 10% than inflation would go to 7%—and I would definitely rule out inflation at 7% in the next few years because interest rates would preempt such a move. If you had the prospect of a weaker dollar, you would also have a greater chance of higher interest rates. But in the present environment, where the [Clinton] Administration has had a change of heart on its attitude toward the dollar, I would rule that out.

Why are you moving into direct investments in power plants and other ventures?

SOROS: We believe there is now a greater return in the real world than in the financial world, and we are moving accordingly. We are taking some of our financial capital and putting it into the real world. There are great returns to be had in investments in the real economy, particularly in emerging markets.

We find that most of our investments are going in that direction.

You recently called Russian President Boris Yeltsin "a spent force." Is the same true for his country's economy?

SOROS: I was hoping to see an orderly transition to an open society, a market-oriented democratic system based on the rule of law. That attempt has basi-

cally failed. But you do have the emergence of a new system: robber capitalism. It is very raw and ugly, but is a very vital, self-organizing system. It can succeed. There are now economic interests that know how to defend themselves.

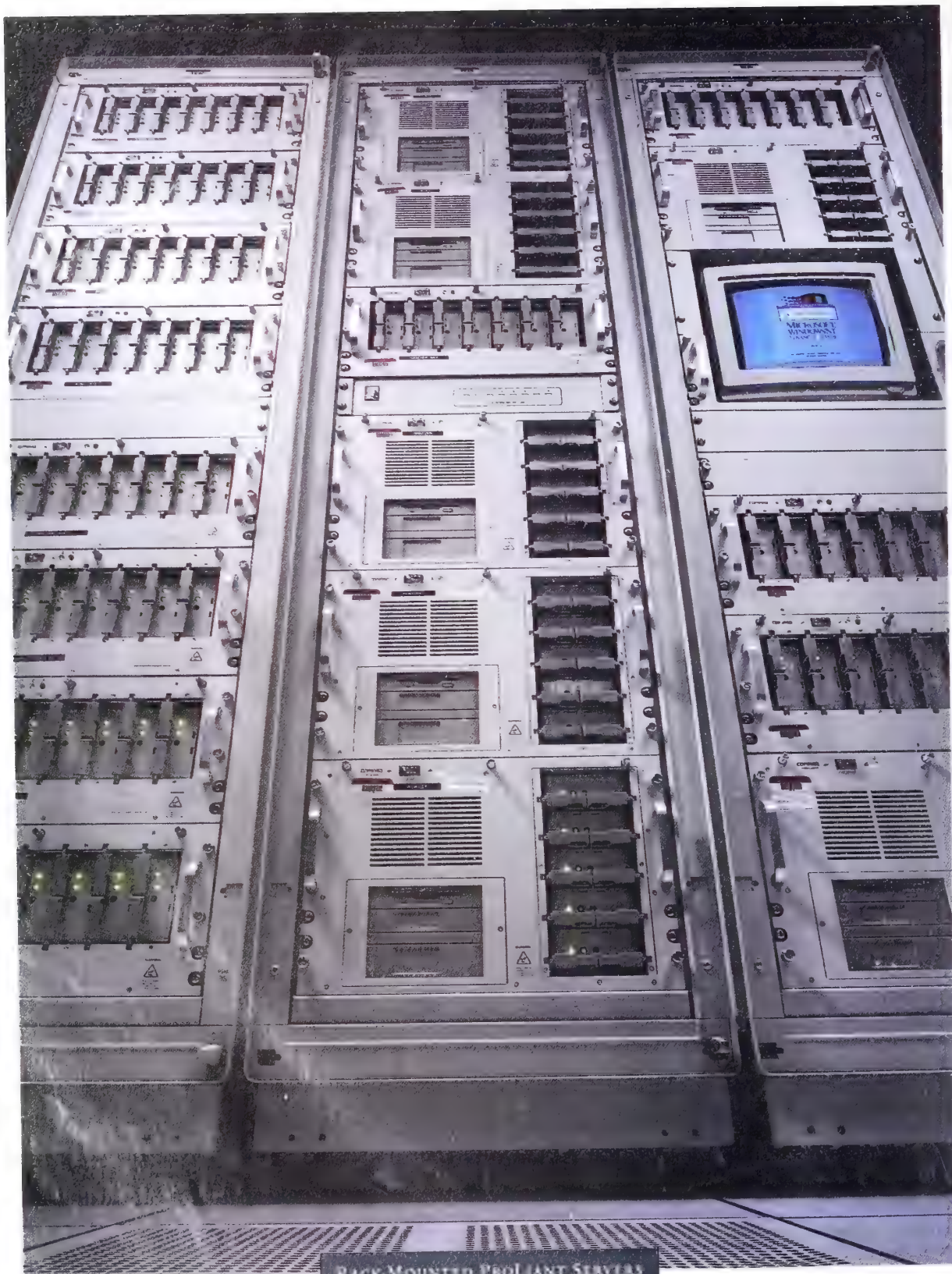
“Until proven otherwise, I have to assume that wage pressures will kick in in the next three to six months”

— STANLEY DRUCKENMILLER

Soros Fund Management,
Managing Director



You have tremendous natural resources in Russia in which it is worthwhile to invest. You could have new growth to offset the continuing decay of the old. But the system is creating a tremendous sense of social injustice and a decline in civilized values. There is a great and pervasive sense of corruption. There is a grave danger that the sense of frustration and disorientation will lead to a political backlash and a xenophobic, nationalistic mood. To contain the growing resentment, two things need to be done. One is to sustain cultural and intellectual life, which is very important to the sense of identity of Russians. This is what my foundation is seeking to accomplish. But more important, you need to provide a social safety net for the large masses who are very badly hurt. This is where the International Monetary Fund and World Bank can play an important role.



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Commentary/by Paul Magnusson

THE IMF SHOULD LOOK FORWARD, NOT BACK

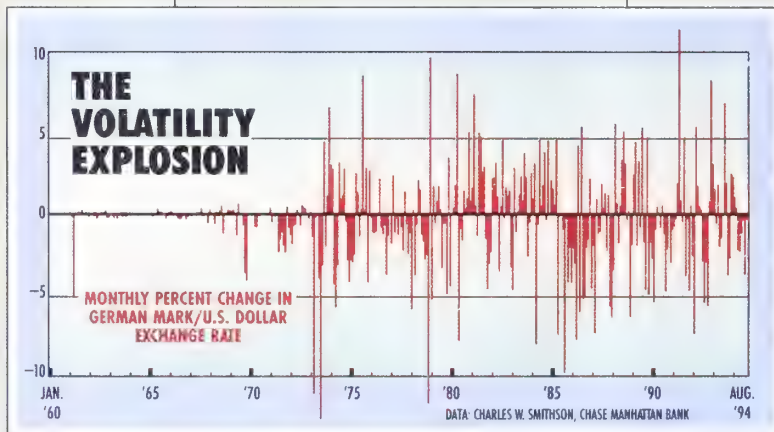
For a lesson in survival, there's nothing like a bureaucracy in search of a mission. When the Salk vaccine wiped out polio in the 1950s, the March of Dimes—founded to combat the dread childhood disease—didn't simply fold its tents. Instead, it went looking for new diseases to conquer. Today, an expanded March raises money to fight birth defects.

Similarly, the International Monetary Fund didn't just wither away in 1973 when its purpose—administering the system of rigid currency controls—was abandoned along with the gold standard. Instead, the IMF assumed a "surveillance" role in the currency markets and began duplicating functions of its sister agency, the World Bank. Now, approaching its annual meeting in October in Madrid, the IMF is trying to reinvent itself with a return to tighter controls on the international currency markets.

That's a bad idea. There is nothing wrong with the \$1 trillion-a-day currency-exchange system that could be fixed by a secretive group of experts beyond the reach of voters and the discipline of the marketplace. In fact, it's only by coincidence that the issue of a new role for the IMF is being raised. Washington considered the 50th anniversary of the conference at Bretton Woods—which created the IMF and the World Bank—far too momentous an occasion to ignore. So a blue-ribbon commission of international financiers was established to reexamine the IMF's function. Headed by former Federal Reserve Chairman Paul A. Volcker, the group came to this conclusion: "The IMF should be given a central role" in persuading governments to "achieve greater economic convergence.... In time, the system might include commitments to flexible exchange rate bands."

Relative currency stability may be a worthwhile goal. But returning the IMF to its initial role is neither possible nor desirable. Today, computers trade bil-

lions of dollars at the speed of light, with currency prices determined by supply and demand. The resulting volatility may give long-term business planners headaches, but it arguably reflects the fair value of nations' legal tender based on the fundamentals of growth, inflation, and interest rates. The IMF "is really a dinosaur from World War II, when it looked like international institutions were necessary to make sure the world didn't fall back into chaos," says Judy Shelton, a senior research fellow at the Hoover Institution.



That assessment is on the harsh side. After all, the IMF has successfully helped to deal with a variety of international financial crises, from the collapse of the European colonial system to the oil shocks of the 1970s and the Third World debt crisis of the 1980s. The IMF is still needed to provide short-term financing to governments struggling to pay current-account debts. And its experts are helpful in establishing free markets in Eastern Europe.

UNSUSTAINABLE COURSE. Yet, with the dollar floating in cyberspace, and the yen and mark growing as world reserve currencies, volatility, uncertainty, and speculation have become facts of life (chart). The days when institutions could have anything more than a short-term effect on currency values are long gone. Nor would returning to a system of fixed rates necessarily be an improvement. "If you get the exchange rate wrong, then you are going to run into enormous trouble," warns economist John Williamson at Washington's Institute for International Economics.

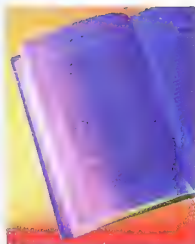
Unwieldy as it may be, the modern currency market exerts its own discipline on governments by punishing them for foolhardy policy decisions. For example, it may be Japanese policy to consistently run a current-account surplus with the U.S. and the rest of the world. But doing so in the face of a relentlessly strengthening yen that makes Japanese exports even more expensive is an unsustainable course. Eventually, export volume will fall fast enough to cut the yen value of overseas sales. Similarly, if the Clinton Administration continues to rely on a weakening dollar to discipline the Japanese, the U.S. economy will suffer from higher inflation and interest rates.

Even the IMF hasn't managed to persuade industrialized nations to institute such reforms as trimming budget deficits or adjusting interest rates. Rampaging inflation or market crashes capture government policymakers' attention much faster. And lately, the IMF's Dutch uncle role has largely been assumed by the Group of Seven summit—the annual meeting of leaders from the world's biggest industrialized nations. Presidents and prime ministers, it turns out, are far better at determining what reforms their countries are able to undertake and what actions domestic politics rules out. That's one sensible mission for the IMF would be to serve as a permanent staff for the G-7. "The IMF is filled with very smart technocrats who are not in position to make overriding political judgments," says Harvard University economist Richard N. Cooper.

Even with the end of the cold war, the triumph of capitalism, and the death of currency controls, the IMF has work to do. And unlike the March of Dimes, the fund shouldn't be looking for new monetary diseases. Currency volatility is the price of a free market, not a condition to be cured.

Correspondent Magnusson covers economic policy from Washington.

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DANGEROUS LIAISONS

"Soft dollars" pervade Wall Street—and may hurt investors

Last year, BMIG Inc. offered Twentieth Century Mutual Funds the Wall Street equivalent of frequent-flier miles. The Atlanta consultant told Twentieth Century that if it steered some of its stock trading business to an affiliated Wall Street broker, the \$27 billion mutual-fund group could have their pick of some 400 services for free.

The services, which ranged from investment research to payment for a \$3 million computer upgrade for the trading room, would be paid for by what the Street calls "soft dollars." Under this widespread practice, brokers effectively grant money managers rebates by allowing them to allocate a portion of the commissions they pay when they trade securities to purchase services

from outside vendors. According to Greenwich Associates, at least one-third of the \$2.4 billion in brokerage commissions spent annually by money managers is converted into soft dollars. Some money managers believe the total is more than \$1 billion and expanding every year. "The services available have grown exponentially," says Theodore R. Aronson, a partner at the Philadelphia money manager Aronson & Fogler.

But as the practice—which goes back at least to the 1970s—has grown, so has the controversy surrounding it. Mutual-fund shareholders and pension participants are generally unaware that investment managers can reap big benefits at investors' expense.

A Securities & Exchange Commission rule permits

"The practice is rife with conflicts of interest"

— HAROLD S. BRADLEY
Head Trader,
Twentieth Century Mutual Funds

fund managers to use soft dollars for anything that "assists them in the decision-making process," such as research reports which tend to benefit investors. The SEC also accepts use of soft dollars for such fund expenses as custodial services and recordkeeping. But over time many managers have stretched the boundaries to such services as computers and cellular phones that don't directly benefit investors.

Even when fund managers use soft dollars to pay for legitimate fund expenses, the payments do not show up as an expense of the fund but are rather recorded as part of the price of the securities that the fund buys. As a result, the fund's expense ratio, a key consideration for many investors, will appear lower than it really is.

What's more, investors may be hurt if money managers choose a broker that offers the best catalog of goodies but not necessarily the lowest brokerage commissions or best executions of trades. "The practice is rife with conflicts of interest," says Harold S. Bradley, Twentieth Century's head trader.

DISCLOSURE RULES? That concern Kansas City (Mo.)-based Twentieth Century to refuse all soft-dollar offers. Indeed, the fund has been fighting questionable soft-dollar practices for years and it has been a lonely battle—until now. The appointment of Arthur Levitt Jr. as chairman of the SEC has vastly improved the prospects for regulatory



THE SOFT-DOLLAR CONTROVERSY



"Soft dollars" are rebates. When a money manager pays a broker commissions to buy or sell securities, the broker in return will often allow the manager to allocate a portion of those dollars to pay for a wide variety of services.

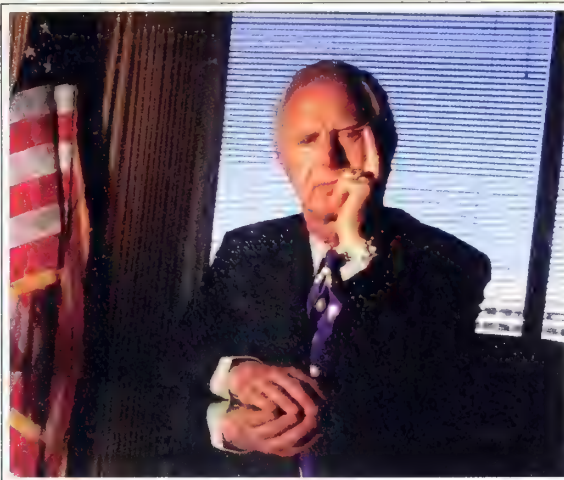
ges in the soft-dollar system. doesn't feel right or smell right," says Levitt. A strong advocate for the individual investor, he has even suggested banning soft dollars entirely. But the practices so prevalent that no one believes that's feasible. At least for the near term, new disclosure requirements, which the agency proposed in August, are more likely. Soft-dollar supporters say the benefits outweigh isolated problems. They argue that research obtained via soft dollars augments in-house research, which helps investors. Some material comes from research boutiques, which "only get paid for high soft dollars and couldn't stay in business otherwise," says Howard J. Martz, president and CEO of Lynch, Ross & Ryan Inc., a soft-dollar broker. In a typical soft-dollar arrangement, a money manager agrees to direct orders to designated brokers at a commission of, say, the current average of 6¢ a share. Typically, the money manager or investor gets \$1 of free services for every \$10 in commissions.

Each of the soft-dollar money goes to investment research. Twentieth Century Securities Bradley received a list of 581 services, available through a Wall Street directory, which included investment research from Standard & Poor's, a unit of McGraw-Hill Inc., which also owns *BUSINESS WEEK*. Subscriptions to *BUSINESS WEEK*, *The Wall Street Journal*, and other publications are also available. Other services on the list were

PROS ▶ Soft-dollar research may enhance investment returns, which benefits mutual fund and pension investors. Soft-dollar payments have spawned independent research boutiques that provide innovative and unique research not available by big brokerage firms.

CONS ▶ Money managers may be getting investors to pay expenses that come out of their own pockets. Money managers may select brokers on the basis of who pays the largest soft-dollar rebates instead of who offers the lowest brokerage rates or the most favorable trade execution. Adding costs to soft dollars may distort the true cost of running a mutual fund and mislead investors.

DATA: BUSINESS WEEK



"It doesn't feel right or smell right"

—ARTHUR LEVITT JR.
Chairman, Securities & Exchange Commission

questionable. Among the "research" providers whose services could be paid for with soft dollars: a Baltimore office-supply store and telephone companies including AT&T, New York Telephone, and Pacific Bell. There's even a lawyer and a doctor on the list whose bills could be paid through soft dollars.

Abuses are relatively rare, insists Lee A. Pickard, a former SEC official and a lawyer representing the soft-dollar lobbying group, Alliance in Support of Independent Research. As evidence, he notes that the SEC has gone after only a handful of firms in the past 20 years.

HARD LESSONS. One recent SEC audit resulted in an enforcement action last November against DeMarche Associates Inc., an Overland Park (Kan.) consultant to pension funds that accepted payment in cash or soft dollars. Regulators said DeMarche charged twice as much for soft-dollar clients as it did for cash customers. The firm settled allegations that it failed to disclose adequately its fees without admitting or denying guilt. DeMarche declined comment.

But many abuses likely go undetected. That's because the SEC doesn't have the staff to audit investment advisers regularly. While mutual funds are reviewed often, the SEC's examination of Twentieth Century's investment adviser unit last year was the first in 35 years, says general counsel William M. Lyons.

Yet if the DeMarche case is in any way typical, it means investors are getting hurt. And it's virtually impossible to ferret out how much, because commissions are not broken out. If a fund buys \$1 million in stock and pays \$2,500 in commissions, the fund's cost of the stock is listed in reports as \$1,002,500. Current

practices make it nearly impossible to detect if the fund is paying higher commissions or accepting a less favorable price to earn soft dollars.

Mutual funds aren't the only target of soft-dollar scrutiny. Now, pension plans are striking deals with brokers. Pension-fund managers can buy anything with soft dollars that aids a plan's beneficiaries, such as services of actuaries, trustees, and consultants. But plan sponsors are getting other freebies, including computers and even cash rebates. John Keane, administrator of the \$500 million Jacksonville (Fla.) Police & Fire Pension Fund, says his fund gets a cash rebate through certain brokers, including Lynch, Jones & Ryan. Since 1987, more than \$700,000 in rebates have been used to pay for the fund's administrative building and a big chunk of operating expenses. "There's nothing soft about getting a check each month," Keane gushes.

MORE SCRUTINY. Not all pension fund executives share Keane's enthusiasm. Cash expenditures are far easier to monitor. "Soft dollars are the dirty little secret in our industry," says M. Steve Yoakum, executive secretary of the Public School Retirement System of Missouri.

What worries investor watchdogs the most is that mutual funds and pension plans may receive inferior trade execution from firms that offer big soft dollars. "Funds may cut commissions to 3¢, but pay 12.5¢ more for stock than they should have," says Paul G. Haaga Jr., senior vice-president of Los Angeles-based Capital Research & Management Co., which manages 26 mutual funds with \$70 billion in assets in the American Funds Group.

Given rumblings in Washington these days, the industry is girding for more scrutiny of soft-dollar practices. Representative Edward J. Markey (D-Mass.) has been pushing for more regulatory control. And after receiving comments on its August proposal, the SEC is expected to require mutual funds to publish soft-dollar expenses in prospectuses. The Vanguard Group, for one, is beginning to disclose that information in shareholder reports. The comments will guide the agency in seeking broad new disclosure of soft-dollar practices of money managers and brokers.

Disclosure is only a mild first step in dealing with soft-dollar problems. Yet if investors start paying attention to the money involved, they might over time start demanding that they, not the managers, reap more of the benefits of the soft-dollar gravy train. If so, Wall Street would never be the same.

By Michael Schroeder in Washington

THE FUTURES FUND THAT GOT AWAY

Missing: Its president—and \$60 million



GOLFER JIM KING SUNK \$380,000 IN A PROMISING FUND RUN BY THOMAS COLLINS (RIGHT)

When his shares in IBM and Glaxo Holdings PLC tanked earlier this year, pro golfer James P. King thought he had found the perfect solution: cash in his stock portfolio and invest in a commodity fund that had been posting annual gains of 30% to 50%. His best friend, who had invested in the fund for years, swore by Lake States Inc. and its charismatic president, Thomas W. Collins.

On June 3, just months after the 60-year-old King handed over his \$380,000 life savings, Collins left his suburban Chicago home and never returned. Now, bankruptcy and civil fraud cases pending in federal court describe Lake States as an elaborate scam, costing some 400 investors as much as \$60 million. The lawsuits allege that Collins, 46, duped a local mayor, a police chief, an anchorman, and dozens of Greek American entrepreneurs—all the while successfully fending off the Commodity Futures Trading Commission, the government agency responsible for regulating commodity firms. In court documents, he is accused of running a Ponzi scheme, paying out "proceeds" drawn at least in part from the money of new investors.

As of mid-September, no criminal

charges had been brought against Collins or other Lake States officials. But the CFTC has filed a lawsuit accusing him and a brother, Edward M. Collins, of massive fraud.

Thomas Collins couldn't be reached for comment. Saying he is the target of a criminal investigation, the brother asserted his Fifth Amendment right in response to the civil fraud charges.

The episode, as documented in court filings, raises serious questions about the CFTC's ability to police the commodities markets. Some 4½ years before Collins disappeared, an informant tipped off the CFTC about suspicious activity at Lake States. Yet agency investigators got nowhere in trying to bring a case. CFTC enforcement chief Dennis Klejna insists that "we tried everything we

could have." Lake States was very uncooperative in finding ways to resist the CFTC's efforts to gather evidence. But critics claim that the CFTC—which is dogged by a reputation for lax oversight—should have brought charges years ago. "The commission had no idea what was going on," declares Chicago attorney Mark S. Boyle, who represented Lake States investors during the agency's probe. When King learned that he had invested his money four years after the CFTC launched its probe, he said, "that made me sick. That's negligence."

The CFTC got wind of Collins in 1989 when an informant told the agency that Lake States was allegedly violating commodity laws by distributing false statements and investing customer funds without the proper license. When CFTC investigators questioned Collins, who didn't have the license, he denied the allegations.

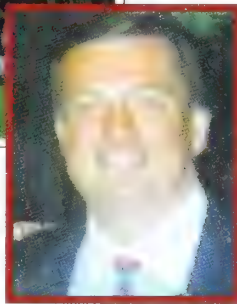
SKIMPY STATEMENTS. Critics say the CFTC should have sought an injunction freezing the company's assets, on the theory that Lake States had improperly solicited funds from the public. Bank records obtained by the CFTC showed that Lake States was receiving millions of dollars

from outside individuals. "All you had to do is walk into the office to know [it] was trading customer money," contends Arthur W. Altmann, a Chicago attorney representing Lake States investors. The CFTC also had records showing alleged trading irregularities. But the agency needed more evidence, Klejna asserts.

The CFTC's biggest hurdle was getting Lake States customers to cooperate with its investigation. For one thing, they had a lot of confidence in Collins, who had been a member of the Midwest America Commodity Exchange, an affiliate of the Chicago Board of Trade, since 1985. His firm's bare-bones monthly account statements showed skyrocketing returns. By the time Collins vanished, investors thought they had amassed \$40 million, according to the bankruptcy trustee in the case.

Much of Lakes States' business relied on word of mouth. The firm hosted lavish parties, including a Christmas bash for 600 last year where guests dined on filet mignon while discussing their fortunes. Collins, dapper in a tuxedo, impressed the crowd with his friendly manner and devoted family.

Clients went along with Lake States requests that they refuse to help the government. "They used to tell everybody to keep it quiet," says Dino Ales,



Critics say CFTC investigators were lax; the feds say investors wouldn't help them



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a suburban Chicago restaurant owner who says he has written off his \$25,000 Lake States investment. Adds the CFTC's Klejna: "We did not get a single human being willing to admit they had a commodity investment with this guy until after he skipped town. If people had been more forthcoming, we would have had a lawsuit sooner."

The CFTC was thwarted on other fronts. It obtained Lake States' account statements from a Chicago-based firm that handled its trades. But Lake States

resisted efforts to follow up on suspicious activity in the accounts. The CFTC had to fight for months to enforce routine subpoenas of bank records.

LOST TIME. Despite Lake States' tactics, critics say the CFTC should have brought a case early on. Even a modest case could have undermined investors' confidence. Instead, the agency spent two years trying to obtain income-tax records from Lake States officials, an effort rejected by an appellate court. An additional 10 months went by be-

fore the CFTC finally brought a case May 19 based on technical trading regularities as much as eight years later. That action may have precipitated the disappearance of Collins two weeks later.

This sorry saga leaves two lessons for investors. One, of course, is that an opportunity seems too good to be true, it probably is. And if you choose to ignore the first lesson, pay special attention to the second: Don't count on the government to protect you.

By Greg Burns in Chicago

CORPORATE GOVERNANCE

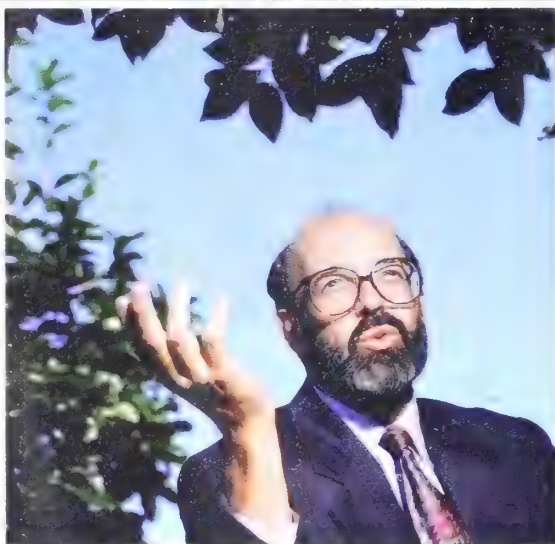
CALPERS' NEW CHIEF: SAME FIRE, LESS FLASH

Mild-mannered Jim Burton means to keep stockholders stirred up

No one who knows him will dispute that Jim Burton has chutzpah. A few years ago, Burton gave his boss, Dale Hanson, then chief executive of the California Public Employees' Retirement System (CalPERS), a book for Christmas. The subject: how to lead. Burton, who has held senior jobs for an assortment of California politicians, including former Governor Jerry Brown, clearly has his own ideas on the matter.

Now, the 43-year-old Burton will have a chance to try them out. On Sept. 16, the CalPERS board named Burton to replace Hanson as head of the powerful \$80 billion fund. To most outsiders, Burton is a total unknown. Soft-spoken and cerebral, he seems the complete opposite of the extroverted and sometimes confrontational Hanson. And Burton's appointment has no doubt stirred a sigh of relief in corporate boardrooms from Boston to Los Angeles. After Hanson's seven-year reign of terror aimed at the likes of General Motors Corp. and Lockheed Corp., Burton at first glance seems like a bland bureaucrat.

BACKFIRE. Burton and others who know him say otherwise. He vows that CalPERS will remain vigilant in its self-appointed job of stirring up shareholders wherever corporate directors are falling asleep at the wheel. "Corporate governance is alive and well at CalPERS and



AS CALPERS' NO. 2, BURTON DID MUCH OF THE LEGWORK

will continue unabated," insists Burton. "It's not dependent on Dale Hanson." After Hanson snagged the headlines, Burton says that he often helped set policy and work out negotiations with companies. "Dale was good at rattling cages," explains Sarah Teslik, executive director of the Council of Institutional Investors, a Washington-based shareholder-rights group. But she adds: "I expect more, not less, out of Jim."

But Burton knows he's going to have to take a more subtle approach than his charismatic predecessor. Hanson's high-profile activism eventually backfired when the CalPERS board publicly worried in 1993 that his agitating was going too far at the expense of the fund's investment performance. "Dale tended to shoot

from the hip and follow his instincts," says DeWitt Bowman, former CalPERS chief investment officer. "Jim takes more of an effort to scope out his choices."

So what should chief executives and investors expect? CalPERS will continue its practice of naming the 10 worst corporate performers. Although he says he will employ a carrot wherever possible, he is quick to point out that the "stick" of shareholder proposals will still be used for companies "that still need a kind of prompting."

HIRED GUN. Unlike Hanson, Burton has no plans to jet around the country personally confronting recalcitrant boards. For that, he has a hired gun: She Pressler, formerly McDonnell Douglas Corp.'s tough, intense chief investment officer, who last spring assumed the same title at CalPERS. Pressler is busy arranging trips to Europe and Japan to bring religion to boardrooms of overseas corporations, where a greater portion of CalPERS' assets are invested. "She's from the corporate world," says Burton. "That can only help us."

Burton's world is strictly Sacramento. An army brat, his outlook was transformed attending college in San Francisco at the height of the antiwar movement in the 1960s. He eventually became Jerry Brown's deputy chief of staff in 1982. He worked closely with California Treasurer Jesse M. Unruh in the 1980s as a finance staffer, sitting in for the legendary shareholder activist at CalPERS board meetings. "I bring my own credentials to corporate governance," says Burton, who is one of the more plugged-in players in the state capitol. His wife, Susanne, a former finance staffer for Governor Pete Wilson, heads a pension education firm.

Although Burton plans to stay out of the limelight for now, Jonathan Luker, New York City's deputy controller who has worked with Burton, says "invisible doesn't mean less effective." To make sure he can pull that off, Burton might want to reread that book about being a leader.

By Eric Schine in Sacramento

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BY GENE G. MARCIAL

THESE SMALL-CAP PLUMS ARE RIPE FOR PLUCKING

Megamergers are back. But don't think just the giants are buyout bait. "In health care, hotels—or media and entertainment—alluring takeover bets can be found among small-cap companies," argues investment adviser Charles LaLoggia. Since few analysts pay attention to them, small companies sell far below their true values, he notes. And they're low in price, so the pool of potential buyers is large, he says.

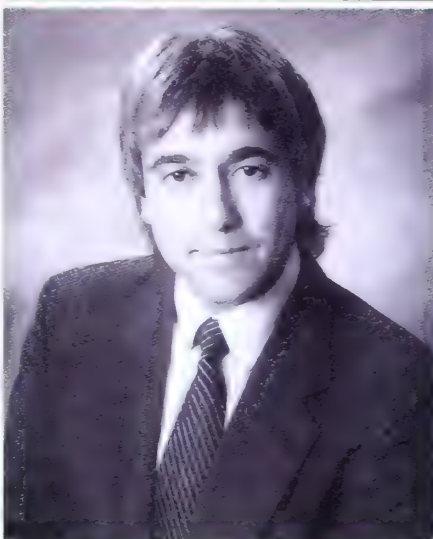
The publisher of *Special Situation Report*, LaLoggia has caught some big winners among his small-cap picks. They include ReLife, which got a \$180 million offer from HealthSouth Rehabilitation on Sept. 19., and Optical Radiation, which agreed in July to be acquired by Benson Eyecare.

Two current LaLoggia takeover bets—RoTech Medical and Salick Health Care—are in outpatient health care, and a third, Microtel Franchise & Development, owns and operates low-cost lodging. All three of them are trading close to their all-time highs, but LaLoggia is convinced they're still way undervalued.

RoTech, now at 9, has a takeover value of \$32 to \$35 a share, figures LaLoggia, who notes that this provider of home health-care services and products is growing at 30% a year. Among other things, RoTech furnishes respiratory care, chemotherapy, and intravenous feeding for cancer and AIDS patients. LaLoggia expects a major hospital company to make a pass at RoTech, although he has no knowledge of any approach so far.

1 MILLION PATIENTS. Salick Health, operator of 10 cancer-surgery centers and 9 kidney-dialysis clinics, is also trading on the NASDAQ at about 9. LaLoggia puts its buyout value at \$35 to \$40, mainly because he thinks that Salick will treat 1 million patients over the next 12 months and perhaps double its sales, to \$200 million. The leap, he says, is partly due to a pact signed in July with Physician Corp. of America, a Miami health-maintenance organization, to provide cancer-treatment services to 100,000 of its members. Salick sees the deal adding \$10 million in revenues.

Microtel, which operates 12 motels



LALOGGIA: HEALTH-CARE AND MOTEL PICKS

with small, no-frills rooms priced 10% to 30% below the cheapest national chain, has been growing rapidly. LaLoggia says the stock, now at 3½, is worth \$13 to \$16 a share in a buyout. Microtel expects to expand to 30 or 35 motels by the end of 1995. It is negotiating for a site in Biloxi, Miss., near the dockside casinos. Richard Sands, president and CEO of Canandaigua Wine, has a 7% stake in Microtel.

WAITING FOR A CEO OPEN TO BIDS

Something is astir at Shared Medical Systems. Reflecting lackluster earnings, the stock had been languishing—until recently. Since mid-August, the stock has been on the rise, going from 22 to nearly 29—in spite of investors' dissatisfaction.

What's cooking? Up to now, Chairman and CEO R. James Macaleer has been unwilling to make executives available to discuss what the company was doing in new technology. But all that is changing. According to a New York money manager, Macaleer is ready to bow to pressure from some board members and appoint an outsider to act as co-CEO.

When that happens, "you'll see the stock jump," says this money pro, who thinks Macaleer has blocked attempts by outsiders to bid for Shared Medical. He senses Macaleer is finally losing his clout, as more executives start to rebel. One big investor has written to Macaleer and the board complaining that management is not responsive at all to shareholders' concerns.

A new CEO, he says, could immediately open the door to the companies he believes have been trying to make a merger or buyout offer: AT&T, Bell Atlantic, and Electronic Data Systems. Shared Medical provides data-processing systems to more than 600 hospitals and 275 physician groups in 48 states. One takeover pro puts Shared Medical's buyout value at \$50 a share.

WHERE S-K-I IS GETTING ITS LIFT

Skiing has been ice-cold, with operators grouching about the unimpressive turnout last year. They aren't anticipating massive crowds this season, either. But Presto Leete Smith, CEO of S-K-I Ltd., the largest publicly traded operator in the U.S., is far from worried. For one thing, S-K-I's stock is headed uphill from 9 a share in late May to 14. And some investors believe it will hit the 20s in a year.

Part of the optimism is due to the ascent in sales and earnings. But there's more: Smith has been acquiring properties, which should push revenues to \$130 million soon. S-K-I posted sales of \$98.9 million for the year ended July 31, 1994.

The company, which owns and operates Vermont's Killington and Massachusetts and California's Bear Mountain, has agreed to acquire a controlling interest in Sugarloaf Mountain, whose property in western Maine generates revenues of \$17 million in 1993. S-K-I also has bought Haystack Ski Area in Vermont, which has sales of \$7 million. "S-K-I has the capital, technology and management to buy up more resorts," says Peter Schliemann of Davy L. Babson in Boston, which owns 7.4% of the stock.

A big rival operator is Ralcorp, which was spun off from Ralston Purina on Mar. 31. It owns the Breckenridge and Keystone resorts in Colorado. But Ralcorp's chief businesses are cereals, baby food, private-label crackers, and coupon-redemption. Some industry analysts say Ralcorp may be thinking of bowing out of skiing and might sell its resorts to S-K-I. One of Smith's objectives is to expand its operations in the West. He has had talks with Ralcorp officials but won't elaborate. "If Smith is able to buy the Ralcorp resorts, revenues of S-K-I would jump to the \$200 million level in a time," says one analyst.

THE DOCTOR WILL SEE YOU NOW—JUST NOT IN PERSON

Health reform and high tech have made telemedicine viable at last

Doctors have long dreamed of the time and lives they could save practicing medicine by wire. Ago, they coined the term "telemedicine" to describe hybrid video communications technology that let them swap medical images over high-speed networks. But the hurdle proved enormous. Shuttling X-rays over phone lines was cumbersome, and

the quality was low. And doctors found that patients were leery, as were insurers. Now that's changing. Amid health-care reform, doctors are more willing to try solutions such as telemedicine to cut costs. Transmitting medical images is getting easier thanks to fiber-optic links. And the technology is getting a political boost. Architects of Bill Clinton's New Information Infrastructure—the basis for the National Information Superhighway—latched on to telemedicine as a high-profile use that could help drive multibillion-dollar Superhighway investments. Donald A. B. Lind, director of the National

Academy of Medicine and of the National Information Office for High Performance Computing & Communications, told Congress in May that telemedicine "will assume ever greater importance as the National Information Infrastructure evolves."

P ADVISE. Last spring, the HPCC—a federal agency initiative Clinton entrusted to develop Superhighway technologies—announced \$26 million in telemedicine contracts. In all, federal support for telemedicine will top \$85 million in fiscal 1995. Now, states are seizing the initiative. In 1990, only three large medical centers were under construction. Today there are more than 70. Georgia is spending \$10 million to link 60 sites with videoconferencing. Oklahoma is investing \$10 million on 38 sites, and 18 other states have programs going. Private companies and universities

are major supporters. BellSouth Corp. is bankrolling Georgia's program. And the University of California at San Francisco (UCSF) is linking five hospitals with fiber optics to cut interhospital delivery of scanned medical images from several hours to minutes. Broadly implemented, telemedicine would reduce annual health-care costs by at least \$36 billion, or 3% of this year's estimated health

care costs—American Telemedicine Assn. President Jane Preston figures the technology could save 22% of the cost of delivering care there.

Telemedicine is also boosting hospital revenues. At Mass General, a team of 70 radiologists has X-rays wired from their own telemedicine center in Riyadh, Saudi Arabia. Since February, the team has "seen" 684 cases, and consultations often end with patients flying to Boston for treatment.

LONG WAIT. Some of telemedicine's biggest beneficiaries may be in the rural U.S. Prior to installing videoconferencing and electronic diagnostics last December, the Tri-County Health Systems center in Warrenton, Ga., referred patients to specialists in Augusta, 50 miles west. Often, says Director Debra C. English, patients balked at the journey. Now, technology spares them the trou-



WHAT'S UP, DOC: HAZEL GRIER WAS TREATED FOR HAND PAINS BY A SPECIALIST 50 MILES AWAY

bill, according to Arthur D. Little Inc.

Telemedicine advocates say most savings will come from videoconferencing—relieving specialists who are on the road too much. "You can get a stock quote anywhere in the world from a handheld device," says James H. Thrall, chief radiologist at Massachusetts General Hospital in Boston. "But to get medical advice, you still need to get into a plane and fly." Or the doctor has to. On any given day, two out of four radiologists at UCSF are traveling. Having scrutinized health care in Giddings, Tex.—pop.

One study has telemedicine trimming \$36 billion off the national health-care bill

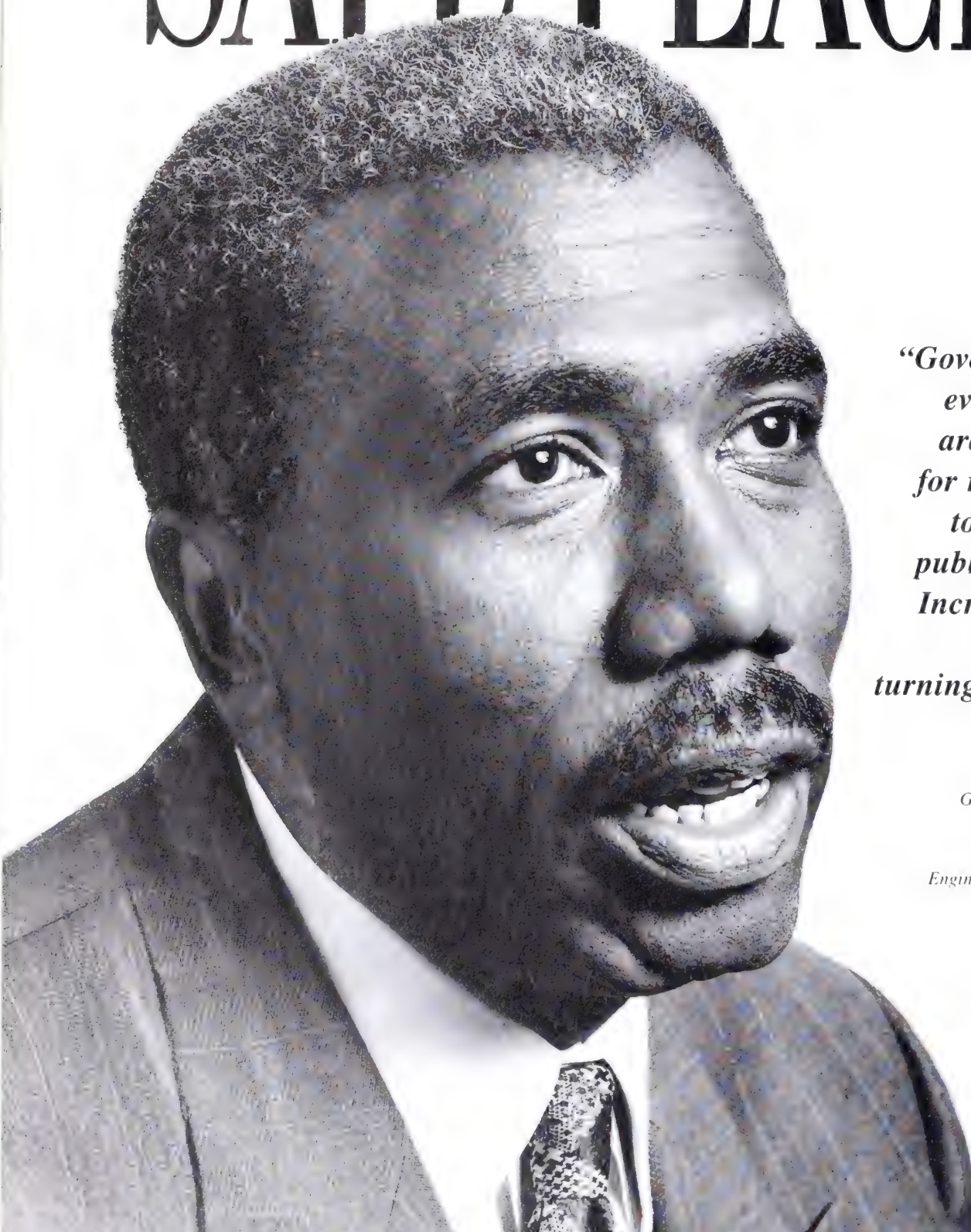
ble. When local doctors failed to relieve cafeteria worker Hazel Grier's hand pains in April, English linked her with a specialist in Augusta who prescribed antibiotics and physical therapy.

Despite such successes, acceptance of telemedicine will come slowly. The Medical College of Georgia spent \$166,000 each on its 60 clinics across the state—which are underutilized partly because the population is sparse. At the Tri-County center in Warrenton, two weeks may pass between videoconference sessions. All told, only 1,000 people were treated by wire last year in North America, according to the Center for Health Policy Research in Denver.

Still, with Washington's support, the numbers are bound to increase. And ultimately, for many patients, diagnosis will start with the click of a mouse.

By Fred Guterl in New York

SAFE PLACES



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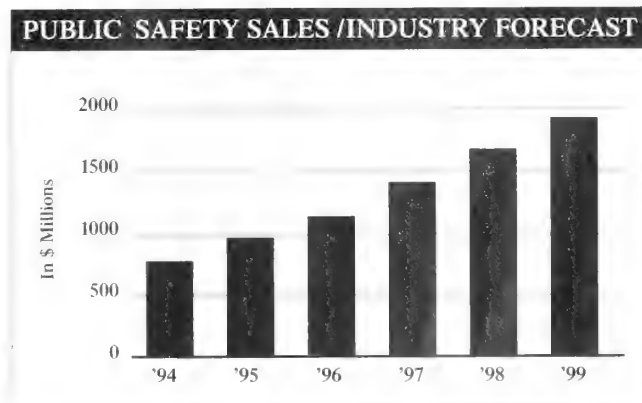
The World Trade Center bombing shook the world. Images of rubble and injury from a seemingly secure place made people wonder where in the world they could be safe. Governments everywhere are looking for new tools to improve public safety. Increasingly, they are turning to TRW.

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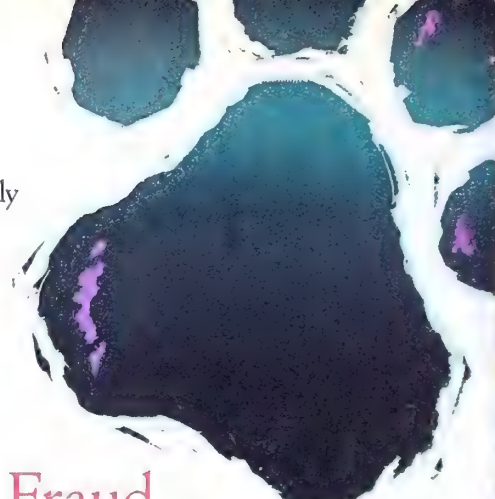
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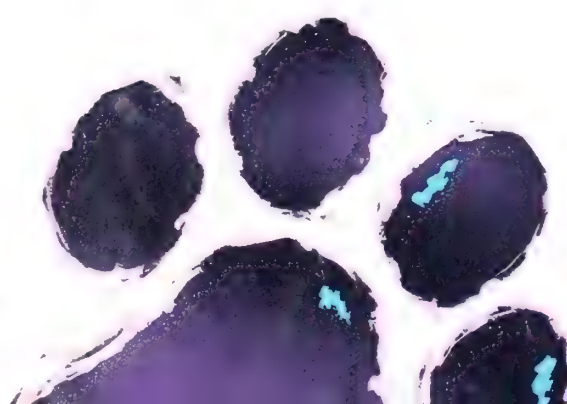
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BY EMILY T. SMITH

THE POLLUTION PATROL FINGERPRINT HYDROCARBONS



Each day, smokestacks, tailpipes, and forest fires belch vast clouds of hydrocarbons into the atmosphere. Clean-air crusaders would love to cork these contaminants, but it isn't always easy to identify the source. Now, researchers at Massachusetts Institute of Technology think they can do that by studying microstructures in soot that should—in theory—

identify each particle's history and source.

Scientists in California have used chemical "signatures" to identify liquid carbon pollutants in Los Angeles smog to commercial barbecues. The MIT team is going after so-called elemental carbon particles that take much longer than liquids to break down. To obtain a "fingerprint," the team runs electron micrographs of soot through computers to generate such details as spacing among the graphite layers. With a large database, says MIT chemist and team leader Adel F. Alkhatib, such signatures could one day identify the specific source that, say, triggered a patient's lung cancer.

HIGH-TECH PHONE, BUILT DOWN TO THE BONE

When is a telephone handset not a handset? When the whole thing fits in your ear. That's the device Jabra in San Diego will unveil on Oct. 15. Called the Jabra ear-bud phone, it resembles those tiny in-ear speakers that let you listen to a Walkman in private—except that this unit is a transmitter as well. It picks up your voice by picking up sound vibrations in your bones. So there's no microphone boom to jut out in front of your face.

Since the bone vibrations must be amplified, a special chip is part of the system that connects to the base of your ear. It uses noise-cancellation technology to screen out background sounds. This antinoise chip generates a mirror image of outside noises, and the colliding sound waves erase each other. The main electronics package—about the size of a deck of cards—also monitors the quality of the phone line and automatically raises the volume of voice transmissions when the connection is weak. This tech-talk ain't cheap: The ear-bud phone will list for \$329.

RIGHT IDEA THAT WORKS: NONTOXIC PHOSPHORS

The cornfields surrounding Michigan Biotechnology Institute in Lansing are a font of innovation. From humble corn, MBI scientists have developed building blocks for plastics, even a salt substitute, and now a photoluminescent material. Research scientist Richard Turk discovered the "lumbi" when he was analyzing corn-derived salt substitutes under ultraviolet light: One glowed in the dark.

Most phosphors, used in everything from lasers to laundry-detergent brighteners, are derived from carcinogenic benzene. But the MBI phosphors are biodegradable and nontoxic. The current formulas glow most visibly under UV light. That means they could be safely used in packaging and food products or as photoactivated switches in fiber optics. Turk and his team are working on a formula that would glow well under fluorescent light, too, for novelty candies and clothing. So far, some 300 companies are testing the new phosphors, including major cereal and candy companies. Chicago-based Ajax Adhesives Industries Inc., for instance, is developing a glue with the phosphor.

A NEW GLASS FIBER GIVES A LOT WITH A LITTLE

Owens-Corning Fiberglas Corp. has developed a new glass fiber called Miraflex. Unlike the short, straight fibers of traditional fiberglass, Miraflex fibers are long, wavy, and soft. When made into insulation, they are highly resilient. A roll of Miraflex insulation could be squeezed down to 9.6 inches in diameter for shipping, then fluffed up when installed to the same thickness as standard insulation that comes in 22-inch-diameter rolls, says David J. Gaul, the technical project leader. Owens-Corning says it expects Miraflex to be used in a very wide range of products, including textiles.

Competitors would love to know how Owens-Corning makes the stuff, but the company won't give details until patents on the new fiber come out next year. Gaul says each filament has two different kinds of glass. One kind cools more quickly than the other, which causes the filament to twist randomly. Glass fibers are made when molten glass is spun around and flies out through holes in the side of a drum. A blast of hot air causes it to "attenuate" into lots of tiny fibers. Gaul will say only that Owens-Corning changed that process somehow to make Miraflex.

DNA SEQUENCING ENTERS THE SUPERFAST LANE

Deciphering the 100,000 or so genes that make up human DNA is a mind-boggling task. It entails sequencing about 3 billion information blocks called "base pairs" whose unique linear order determines the function of each gene. Researchers depend on two technologies to sequence: so-called gel sequencing, developed in the 1970s, and sequencing by hybridization, or SBH, a patented technology invented in the early 1990s and owned by Hyseq Inc. in Sunnyvale, Calif. SBH has an edge: It can be one-twentieth as expensive and at least five times as fast as the older process.

Now, Hyseq intends to make it even faster. It has licensed a "superchip" technology invented at Argonne National Laboratory that allows SBH to be done on a 1-inch-square plate and that can identify the chemical sequence of genes 1,000 times faster than gel sequencing. It will take some four years and up to \$20 million to complete development.





COMPTROLLER OF THE CURRENCY LUDWIG: NEW RULES ON LENDING BIAS ARE HERE TO STAY

ALARMS ARE GOING OFF AT THE BANKS

True, bankers won on interstate banking. But wait till next year

Don't be surprised if bank officers cast a gimlet eye at their customers this fall. Just as banks are making serious inroads into a new business—mutual funds—government regulators are preparing to send undercover shoppers into bank lobbies. The mystery shoppers, under contract to the Federal Deposit Insurance Corp., will fan out across the country to unearth any unsavory marketing practices banks may be using to lure customers into investing in uninsured products.

And that's not the only place bankers will feel sharper scrutiny. After winning congressional approval for interstate banking and a bit of regulatory relief, bankers are finding the going in Washington tougher. Banks' dealings in derivatives are getting increasingly in-

tense oversight. Regulators are investigating reports that Citibank and NationsBank Corp. have illegally tied the extension of bank credit to other services. The Clinton Administration is cracking down on banks that neglect low-income borrowers. And the industry is bracing for a brawl with less prosperous thrifts, which want to tap into the flush bank-deposit-insurance fund. "It was a helluva year," says banking lobbyist James J. Butera, who represents more than a dozen financial institutions. "But next year, banks will be back on the defensive."

At least their position will be familiar. Except for interstate banking—which congressional staffers say was less a vote of confidence in the industry than a nod to a de facto trend—bankers have

rarely cheered congressional action. The FDIC Improvement Act of 1991, which started out as a bill to overhaul the financial-service business, produced a law that bankers say has burdened them with red tape. And last year, Congress passed a bill at the Administration's urging that is taking away a large chunk of the profitable student-loan business.

Congress started focusing on the biggest potential financial time bomb—derivatives—earlier this year. It's kicking around five bills to regulate these complex financial instruments. One measure, sponsored by House Banking Committee Chairman Henry B. Gonzalez (Tex.), includes a thorny provision banks say will make them responsible for determining if derivatives are "suitable" for customers. Despite a recent plea from the Treasury Dept. to back off, Gonzalez will likely make his bill a top priority in 1995, congressional staffers say.

"FALSE IMPRESSION." Some derivative players are starting to mobilize. Denis Weatherstone, chairman of J.P. Morgan & Co., visited Capitol Hill last June to teach a group of financially uninitiated members of Congress the virtues of derivatives. And the International Swap & Derivatives Assn. is sending people to Washington to lobby. But some bankers—and their supporters in Congress—contend the industry hasn't done enough. It's "laboring under the false impression that nothing will be done," says Representative Rick A. Lazio (N.Y.), a freshman House Banking Committee member who says legislation is unnecessary.

Even if Congress doesn't act, however, regulators are making bankers sweat. This summer, the Treasury Dept. and the FDIC warned examiners about the riskiness of structured notes—debt instruments with derivatives built in. And by the end of October, the Office of the Comptroller of the Currency (OCC), which oversees national banks, will issue new guidelines for determining if banks have adequate controls over their derivative businesses. Bankers grouse that strict supervision is unnecessary and that the added regulatory burden will give rivals—securities firms and international

PUTTING BANKS ON THE DEFENSIVE

Clintonites are moving on several fronts:

MUTUAL FUNDS

As Treasury investigates mutual-fund sales practices at NationsBank, other lenders brace for undercover FDIC visits to find marketing abuses; Congress may strictly oversee sales practices.

DERIVATIVES

Bank regulators are stepping up scrutiny of bank derivative activities; Congress may weigh in with new restrictions on these financial instruments.

FAIR LENDING

A Justice Dept. lending-bias settlement with a Maryland thrift has banks scrambling to determine if they'll be targets of similar aggressive enforcement.

INSURANCE REFORM

Banks are fighting a thrift industry plan to merge their weak federal deposit insurance fund with the banks' healthy fund. It could cost banks \$10 billion.

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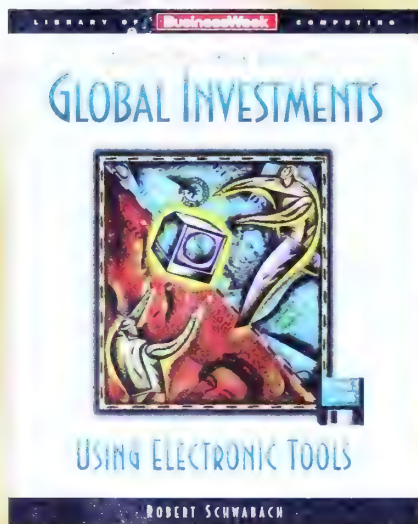
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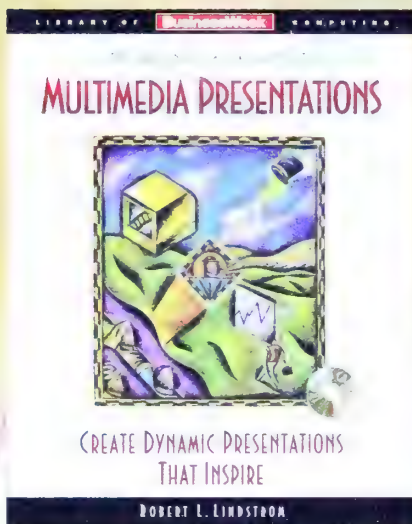
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itors—an edge. “We can’t afford this business,” says one banker. It’s especially true with regulators in on the fast-growing mutual-fund businesses. While the FDIC prepares to out those mystery shoppers, OCC regulators are conducting detailed examinations of bank mutual-fund activities. They’re also investigating charges that NationsBank engaged in deceptive sales practices in its brokerage business. Meanwhile, banks are also edgy as regulators look over their shoulders in interstate lending. A rule proposed last year to clarify bank requirements under the Community Reinvestment Act of 1977 (CRA) set off a firestorm of protest from the industry. The Administration tried to make sure lenders weren’t being discriminating, but banks howled that the rule amounted to credit allocation. Now being rewritten to respond to the confusion over what it requires, OCC head Eugene A. Ludwig vows regulators are not backing off. “Institutions that would like us to eliminate CRA are like it,” he says.

SCENARIO? The Justice Dept., cracking down on lending bias, recently reached a \$11 million settlement of red-charges with Maryland’s Chevy Chase Federal Savings Bank, among others. Sent bankers scrambling to see if they’re exposed to a similar action. “Nobody needs to challenge Justice,” says former FDIC Chairman William M. Isaac. “They went well beyond the law here.”

Meanwhile, bankers are negotiating with regulators. But they’re arming for battle. Savings and loan associations over a decade ago merged their deposit-insurance funds. The once withered bank fund has been replenished by mid-1995, although the premiums banks pay to be insured. The thrifts’ fund, though, will take eight years to recover. The FDIC’s Office of Thrift Supervision worries that high premiums will shrink the industry and require a federal bailout of the S&L fund.

The American Bankers Assn., which dismisses that scenario as fantasy, estimates that a fund merger would cost \$10 billion. Yet some bankers argue that they may have no choice but to go along. In return, they hope to win expanded rights to sell securities and insurance.

It may be too much to expect. Although 1994 was an uncommonly quiet year, bankers know it’s always a battle to wrest new powers from regulators. In 1995, they’ll probably have to settle simply for not losing big.

Amy Barrett in Washington, with David Greising in Atlanta

RIGHT THIS WAY, MR. McCOLL. YOUR HOT SEAT IS READY



McCOLL FACES HEARINGS ON THE HILL

For Hugh L. McColl Jr., it was money in the bank. On Sept. 13, after an intense, four-year campaign, the powerful CEO of NationsBank Corp. and friend of Bill Clinton saw a dream realized: congressional passage of an interstate banking law that lets McColl consolidate his nine-state empire—and save NationsBank \$50 million a year.

But if McColl is less than ecstatic, there’s good reason. His bank is getting unwanted attention from the House Energy & Commerce Committee. Chairman John D. Dingell (D-Mich.) plans to hold hearings after the November elections on allegations that NationsBank is forcing customers to accept additional services in exchange for loans and other bank products. The Office of the Comptroller of the Currency is looking into these “tying” allegations as well. Banks may link some products for marketing purposes, but restrictions are still in place for certain types of transactions.

And if that isn’t enough, the OCC is investigating NationsBank’s mutual-fund sales practices: A former employee and three customers have filed lawsuits accusing the company of deceptive marketing. McColl wouldn’t comment for this story, but a spokeswoman says the bank is cooperating with the OCC in the tying probe and will defend itself against the mutual-fund claims.

Considering McColl’s reputation as a Washington insider and his company’s generous political contributions (chart), NationsBank is a surprising target. NationsBank has given \$437,000 to congressional candidates running this fall, and McColl relishes his status as a Presidential pal. He sat next to Clinton during last spring’s National Collegiate Athletic Assn. basketball championships in Charlotte, N.C., where NationsBank is headquartered, and he’s one of a small group of CEOs that Clinton regularly turns to for advice.

McColl has long been an Inside-the-Beltway player. He kept interstate banking alive after the measure was stripped from a banking overhaul bill in 1991. Following that setback, NationsBank’s chief lobbyist, J. Mark Leggett, headed a group of six big banks that tirelessly promoted the legislation on Capitol Hill. Last year, when opponents tagged the measure a “NationsBank bill,” McColl broadened his campaign by folding his “Gang of Six” into the Bankers Roundtable, a trade group for the nation’s largest banks. “That was a very smart move,” says John S. Rippey, a Roundtable lobbyist.

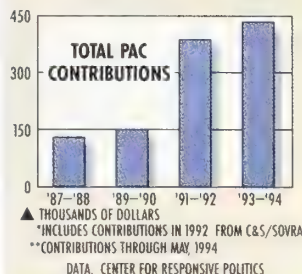
SAVVY LOBBYING. Leggett also stroked the enemy. Kent Brunette, a lobbyist for the American Association of Retired Persons, penned a letter opposing the bill’s lack of consumer protections in August but decided not to send it to the Hill after Leggett promised to help develop industry guidelines for providing low-income customers with inexpensive services.

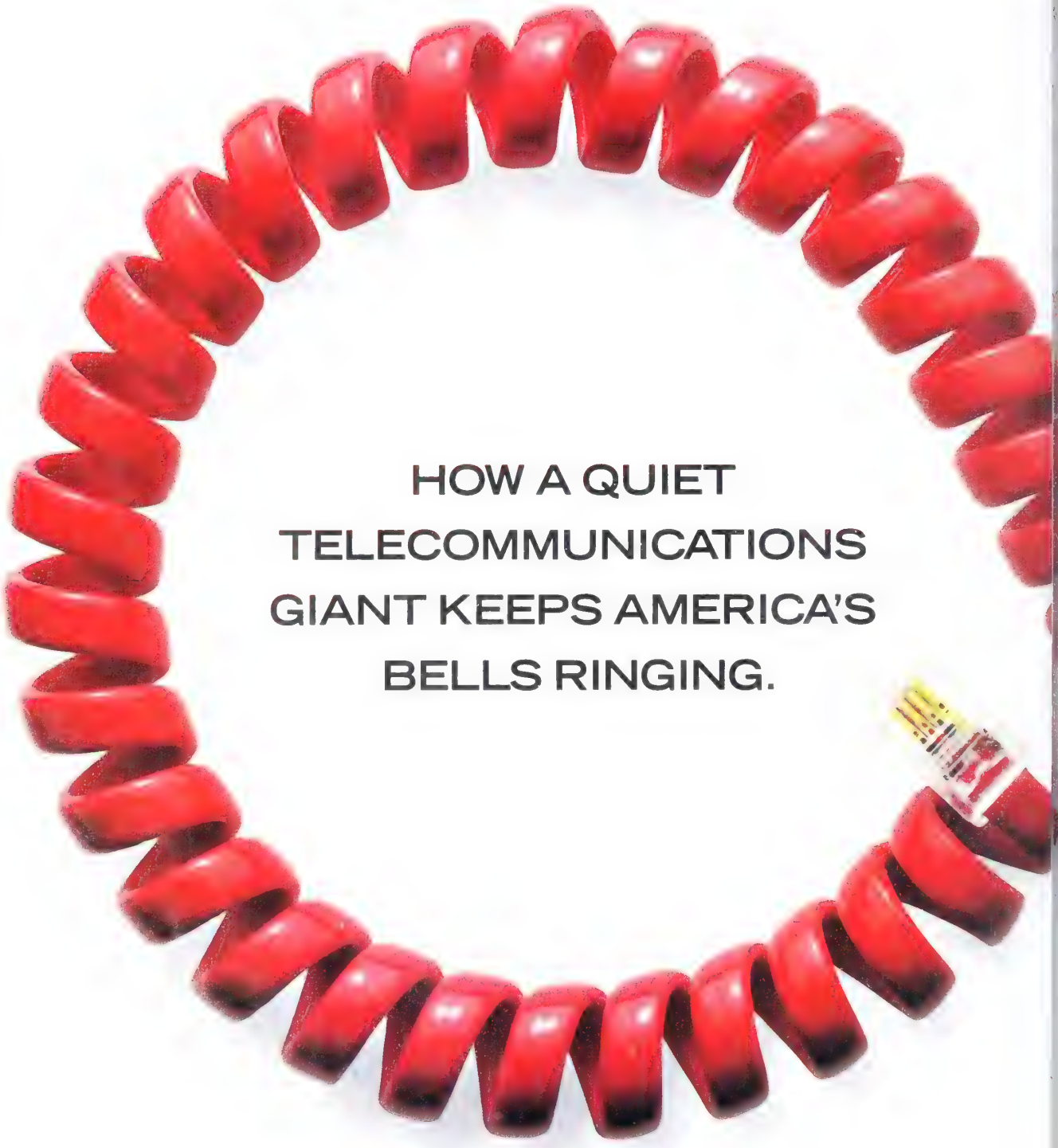
Savvy lobbying, however, won’t keep McColl off Dingell’s hot seat this fall. The powerful Hill veteran rarely misses an opportunity to slam bankers for overly aggressive tactics. And the bad publicity about NationsBank’s mutual-fund woes could add momentum to

a legislative drive to give the Securities & Exchange Commission more oversight of bank-securities operations. The interstate battle is won, but for McColl, there are plenty of fights ahead.

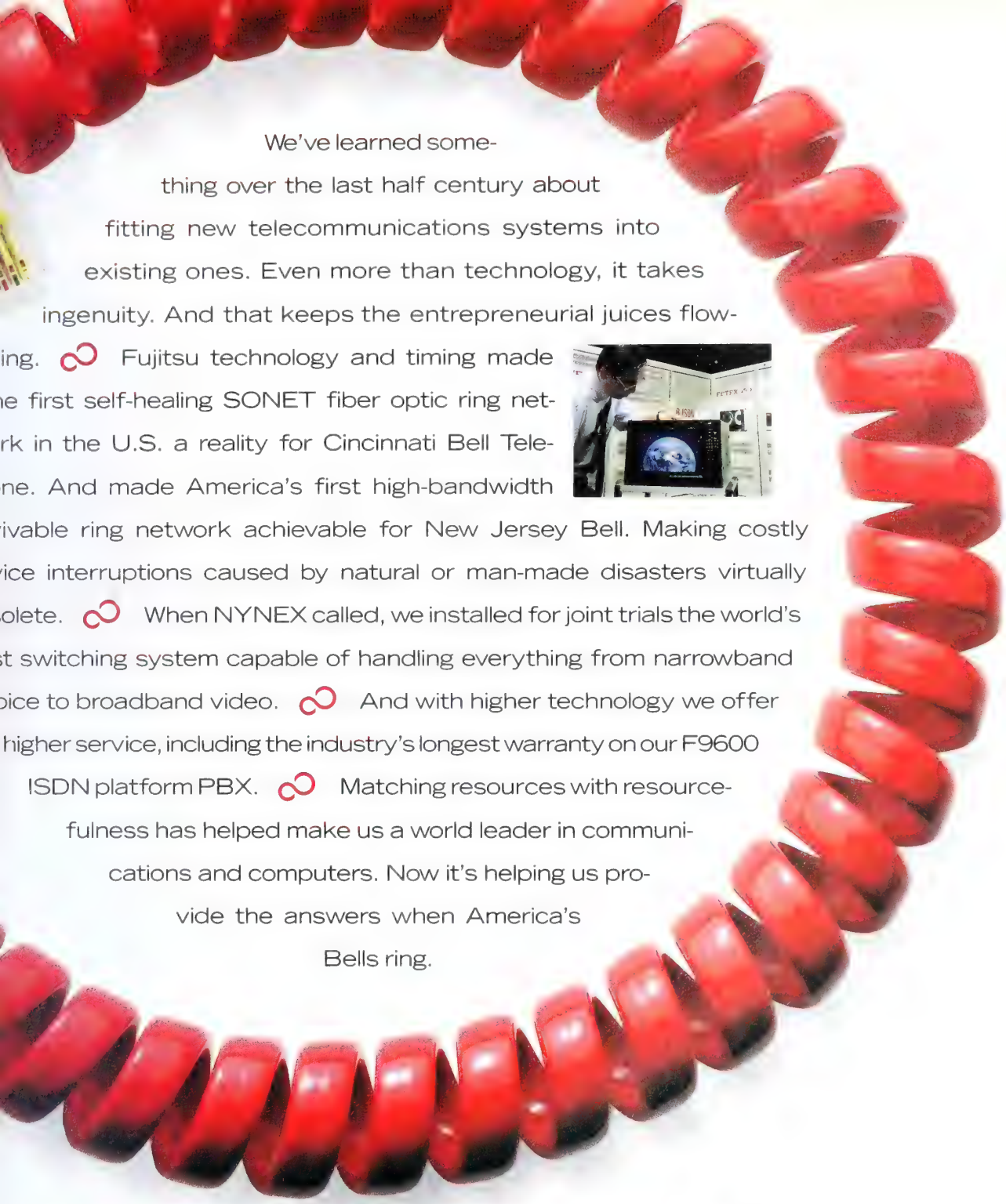
By Amy Barrett in Washington, with David Greising in Atlanta

NATIONS BANK'S POLITICAL GENEROSITY





**HOW A QUIET
TELECOMMUNICATIONS
GIANT KEEPS AMERICA'S
BELLS RINGING.**



We've learned something over the last half century about fitting new telecommunications systems into existing ones. Even more than technology, it takes ingenuity. And that keeps the entrepreneurial juices flowing.  Fujitsu technology and timing made the first self-healing SONET fiber optic ring network in the U.S. a reality for Cincinnati Bell Telephone. And made America's first high-bandwidth survivable ring network achievable for New Jersey Bell. Making costly service interruptions caused by natural or man-made disasters virtually obsolete.  When NYNEX called, we installed for joint trials the world's first switching system capable of handling everything from narrowband voice to broadband video.  And with higher technology we offer higher service, including the industry's longest warranty on our F9600 ISDN platform PBX.  Matching resources with resourcefulness has helped make us a world leader in communications and computers. Now it's helping us provide the answers when America's Bells ring.



FUJITSU

COMPUTERS, COMMUNICATIONS, MICROELECTRONICS

Commentary/by John Carey

WE CAN FIGHT SMOG WITHOUT BREAKING THE BANK

The war against air pollution is a costly and frustrating regulatory morass. Despite spending \$400 billion over the past 25 years, America is still fighting one of its most noxious forms of pollution—the ozone haze called smog. In the stratosphere, ozone protects humans from dangerous levels of ultraviolet light. But in the air we breathe, the same chemical harms everything from lungs to trees. Not only do levels of ozone violate federal air-quality standards in 93 U.S. metropolitan areas, but new studies suggest those standards aren't tough enough to protect health and the environment.

The U.S. is about to renew its assault on ozone. The 1990 Clean Air Act requires states with dirty air to develop blueprints by Nov. 15 for slashing emissions from cars, power plants, and other ozone sources. Meanwhile, the Environmental Protection Agency and 12 Northeastern states (plus the District of Columbia) are wrangling with the auto industry over a key part of the region's antismog drive: a plan that would require carmakers to sell cleaner "California" cars—including electric vehicles—in the Northeast.

COSTLY ROUTE. At stake is not just cleaner air but tens of billions of dollars. That's how much more taxpayers, auto buyers, and businesses will spend if the nation makes the wrong choices. Unfortunately, state and federal regulators may be heading down the more expensive road, as politics, ideology, and scientific uncertainty combine to perpetuate past mistakes.

To understand why, look at the chemistry of ozone. Two types of pollutants, nitrogen oxides (NOx) and volatile organic compounds (VOCs), contribute to smog—but in different ways. Nitrogen dioxide (NO₂), a form of NOx spewing from tailpipes and smokestacks, forms ozone directly. When zapped by sunlight, it gives up an oxygen atom, which then joins with oxygen gas (O₂) to form ozone (O₃). VOCs such as unburned gasoline, paint fumes, and natural hydrocarbons contribute through a more complicated route. They react with another form of NOx, nitrogen oxide (NO), to make NO₂—thus supplying more fuel for the first ozone-making reaction.

So what's the best way to fight ozone—cut back on VOCs or on NOx? For decades, regulators put their money on VOCs. "The industries involved preferred hydrocarbon controls to NOx controls," explains University of Michigan atmospheric chemist Sanford Sillman, since those cuts were easier and cheaper. Besides, early computer simulations suggested that the strategy would work for most of the country. Only in California, where ozone sometimes soared to more than three times the current maximum federal standard

not NOx was a mistake," concludes atmospheric chemist James N. Pitts of the University of California at Irvine. "The country—outside of California—is now paying for that."

The U.S. continues to make same blunder. While the strategy mainly should be aggressive reduction of NOx, federal and state regulators are pushing instead for added expensive cuts in hydrocarbons. The Clean Air Act, for instance, requires polluting areas to use gas spiked with extra oxygen—a so-called alternative fuel.

CLEARING THE OZONE

Forcing electric cars on the Northeast won't get rid of smog. Neither will oxygenated fuels. Here are six steps that might make a difference:

- ▶ Shift regulatory emphasis from volatile organic compounds (VOCs) to nitrogen oxides
- ▶ Accept auto makers' proposal to build a cleaner 49-state car, instead of special cars for the Northeast
- ▶ Tighten NOx emission standards for utilities
- ▶ Let carmakers, utilities, oil companies, and other polluters trade emission credits, so the market can find the cheapest solutions
- ▶ Use remote sensing to spot the 10% of cars that produce over half of all tailpipe emissions
- ▶ Create incentives for using mass transit and car pools

of 120 parts per billion, did authorities mandate cuts in both.

In many urban areas, however, reducing VOCs hasn't worked. The reason, new research shows, is that emissions of hydrocarbons are three or four times higher than anyone expected. Some of these come from cars. Another big chunk comes from trees: Air over much of the Northeast contains more naturally occurring hydrocarbons than man-made VOCs. Given current levels of NOx, even eliminating man-made VOC emissions won't bring ozone levels below the federal standard in many areas. "The focus on VOCs and

The oxygen, which makes the fuel burn more cleanly, comes from ethanol (made from corn) or methanol (made from natural gas). Studies show that these additives, which raise the cost of gas 2¢ to 4¢ a gallon, can increase tailpipe emissions yet offer only a small cut in VOC emissions. Worse, the EPA in June made good on a Clinton campaign promise to farmers, ruling that 10% of the oxygen must come from renewable sources, meaning ethanol, which is more expensive and polluting option. "It's a terrible decision," says a congressional aide.

A decision by Northeast states to

ultralow- and zero-emission auto would be harmful, too. Such manufacturers are being pushed by environmentalists, states such as New York, Massachusetts, and some EPA officials. Voltmobiles—electric cars—“hold promise for energy strategy and building a healthy economy,” says a EPA official.

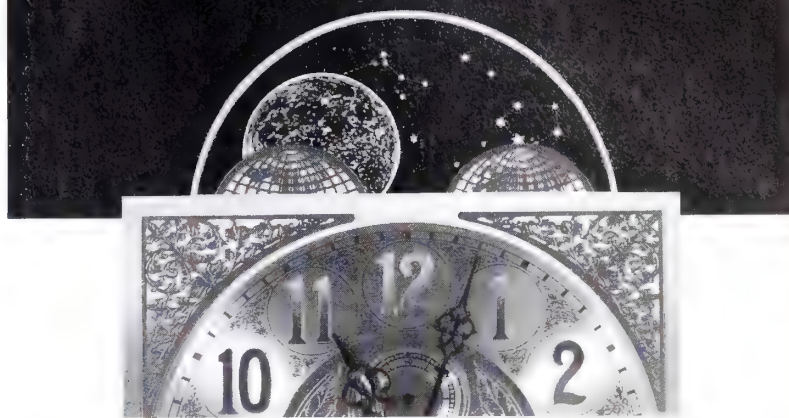
These claims are questionable. And when it comes to ozone, electric cars are not a costly nonsolution. True, the vehicle is pollutant-free. But power plants supplying the juice spew out tons of NOx. This isn't a problem in Southern California, since most of its power plants are far from the smoggy Los Angeles basin. But in the North, utility emissions of NOx are a major cause of smog. An internal EPA study shows that, under some conditions, NOx reductions from electric cars are offset by increases from utilities. Cleaning up power-plant smokestacks will alter the equation. But even so, NOx benefits from electric cars will be small.

MAGIC BULLET. That's why states such as the EPA should take the Big Three automakers up on a proposal to reauthorize the California plan in the North with a low-emission, gas-powered vehicle that would be phased in everywhere but California beginning in 1999. Under this 49-state car would emit only one-half the amount of VOCs than ultraclean California vehicles, it would match them for NOx, spewing out only one-half the amount coming from today's cleanest cars. Spread over all cars sold, the cost would be less than \$600 per vehicle for the 49-state car, vs. \$3,000 if auto makers build electric models for the Northeast. The plan would also cut pollution across the country, slashing the amount of NOx and VOCs blowing into the North from the West and South.

Of course, the 49-state car is not a magic bullet. States must also require tighter cuts—up to 75%, some scientists estimate—in NOx emissions from homes, factories, and other sources. Emissions trading would help the market find the cheapest reductions. States could deploy curbside pollution sensors to nab the dirty 10% of cars that account for half of today's auto emissions. Some cities also need to boost mass transit and impose restrictions on driving. But if the U.S. avoids electric mandates and repeals oxygen-fuel regulations, it won't have to pay an unnecessarily high price to get rid of the ozone.

Washington science writer Carey Haines writes on a zero-emission bicycle.

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MASTERING YOUR PC RIGHT OUT OF THE BOX

Despite years of hype surrounding ever-simpler-to-use personal computers, many PCs still aren't as easy to master as they ought to be. Novice users too often are lost from the moment they take the machine out of the carton. Even experienced computer hands sometimes find the popular operating system Microsoft Windows a bit capricious and inefficient.

Computer buyers take heart: The PC industry claims to share your pain. A number of manufacturers are creating a more pleasant out-of-box experience by installing friendly front-end software on their newest machines. Such programs promise to help users better organize files, complement Windows, and otherwise figure out how to get up to speed more quickly.

Packard Bell maintains that its graphical front end, called Navigator 2.0, "makes using a computer as easy as channel-surfing with a remote." Indeed, in a test of three programs by BUSINESS WEEK and National Software Testing Laboratories (NSTL), both owned by McGraw-Hill, Navigator emerged as the front end of choice for novices.

AST Research says AST Works software "zaps PC-phobia." And Compaq Computer insists that TabWorks from XSoft, which is included in most of the company's computers, is an "easy-to-use alternative to the Windows Program Manager"—especially for seasoned users, our test found. XSoft, a division of Xerox (800 428-2995), sells TabWorks separately for \$49 plus shipping to dissatisfied Windows users who own rival PCs. Of course, those folks might want to wait



FRONT-END programs kick in when you turn on the machine—and teach complicated software step by step

for the Windows95 program (also known as Chicago) that Microsoft is scheduled to bring out next year. If it lives up to promises, the revamped interface should solve some problems of the old version.

IBM has also been trying to

figure out how to make PCs easier to operate. This September, it unveiled a front end on its Aptiva line of PCs that contains, among other things, an index with 200 alphabetically listed common computer tasks, such as Add

New Software and Balance Checkbook. By clicking on any of these items, users can get simple instructions on how to handle those functions and automatically start up the appropriate software.

Also in September, Acer introduced Acer Computer Explorer software, which arranges applications into a menu of six categories. In the My Favorites section, users can click on buttons that launch pre-installed programs such as Microsoft Works and Davidson MathBlaster. The My Games section is where you'll finditaire and Microsoft Golf. The Communications option people can take off into cyberspace via Prodigy, America Online, or NetCruiser for

NetCom, a link to the Internet. Once buyers consider technology and price, Ronald Chwang, president of Acer America, "the interface is an intangible that adds to the experience."

VOCAL ICONS. Anyone trying to evaluate this intangible has a number of things to consider. Are the icons easy to recognize and understand? Do they start with computer tasks that others take multiple steps? Does the front end provide a significant advantage over Windows? (For that matter, if you're already keen on Windows, can you easily bypass the native interface?) BUSINESS WEEK and NSTL considered these and other factors while evaluating TabWorks, Navigator, and AST Works.

As the oldest of the programs tested, TabWorks doesn't provide the multimedia splash of Navigator or Works. The intuitive TabWorks shell resembles a three-ring notebook and

advantages over Windows, particularly for users whose screens are cluttered with icons. All the icons in the "book"—representing software programs or documents, spreadsheets or word processor files—are listed by name and page in a table of contents. Further, colorful pages aggregate pages into sections that make sense to you, whether frames or business reports. By clicking on the icon, you can instantly move to that part of the book. A quibble: As with a ring-bound leaf binder, the names of the tabs appear sideways. One of the best TabWorks features is an alphabetical index of all the items in the book, which is handy if you can't remember in which section a program resides. Moreover, you can use a mouse to click on the icons for programs, and on most to a strip on the left edge of the display. A single click on that icon opens the program.

TabWorks comes on AST computers and with a glitzy video introduction from an executive who thanks you for buying the computer. A four-minute video provides the basics of turning the interface, and even techie beginners can even learn a lesson on how to handle a computer mouse.

The heart of the program is a main menu featuring buttons for different functions that lead to other menus (communications, productivity, financial) you click on them. But

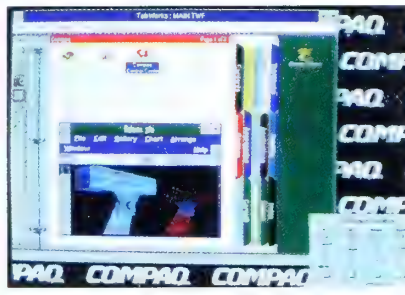
the gray graphics look bland, and you can't easily deduce what will happen if you click on the separate set of icons that appears on the left side of the screen. But AST includes a variety of small software tools that let you produce greeting cards and banners or keep track of your car's maintenance schedule.

An "Ask AST" option is the strongest feature. Neophytes can consult a list of frequently asked questions, such as "How much RAM do I have in my computer?" or "How many serial (COM) and parallel (LPT) ports do I have on my computer?" There's also a glossary that defines some of the jargon. A kilobyte, a user is told, is 1,024 bytes. That wouldn't be instructive for people who don't know what a byte is, but the term is color-coded, so a user can click on it to read a more complete explanation. You can also click on a speak icon to hear a synthesized voice read highlighted text. And some help topics are accompanied by videos.

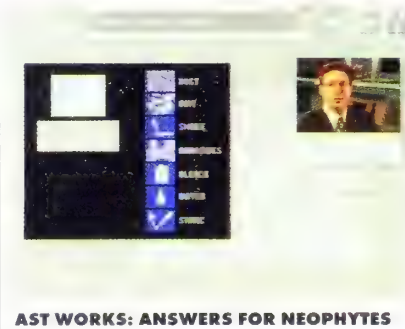
Visually, Packard Bell's Navigator is the most engaging of all the front ends. When the computer is first turned on, users enter into the three-dimensional hallway of a virtual house, leading to rooms (or areas of the computer) best suited for different family members. The



NAVIGATOR: HIGHLY KID-FRIENDLY



TABWORKS: ALTERNATIVE TO WINDOWS



AST WORKS: ANSWERS FOR NEOPHYTES

Software section includes Prodigy and programs such as Microsoft Money that have been preloaded on the computer. In the Learning Center, users can find out about upgrading the system. A troubleshooter section, complete with Q&As, videos, animations, and diagrams, helps novices

understand printers, monitors, and safety tips without bogging them down in technospeak. The interface in the Workspace area, a replacement for Windows' program and file manager, is easy to use, though cluttered, and could have benefited from an alphabetical index such as the one included in TabWorks.

TREMORS, TOO. Children will probably be most impressed with Navigator. Its Kidspace is an on-screen playroom that appears as either a 3D space station or tree house. As kids enter Kidspace, they can hear the giggles of mischievous children. An animated jack-in-the-box greets them. A variety of programs start by clicking on objects in the room. (Depending on how often the room is cleaned, the objects may be sitting in their places on the bookshelf or lying on the floor.) Kids can store letters, homework, and paintings in a chest of drawers. Random events also occur: Along may come a spider, spaceship, or the shakes of an earthquake.

Parents may get annoyed by the sound of creaking doors, but the good news is they can turn off noises and conjure up passwords to keep kids out of certain areas. The only problem is, if your kids know more about PCs than you do, they may lock you out first. *Edward Baig*

EVALUATING THE FRONT ENDS

	INTERFACE	ON-SCREEN HELP	LEARNING THE SYSTEM	TUTORIAL	USEFULNESS	OVERALL IMPRESSION	COMMENTS
							EXCELLENT ★★★★★ GOOD ★★★★ AVERAGE ★★★ FAIR ★★ POOR ★
PACKARD-BELL NAVIGATOR	★★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★	Vivid graphics and sounds, and particularly engaging for kids
TABWORKS	★★★★★	★★★★★	★★★	★★★★★	★★★★★	★★★★★	Lacks multimedia glitz but is best for organizing files and starting up programs
AST WORKS	★★	★★★★	★★	★★★★★	★★	★★	"Ask AST" feature is strong, but program is no big improvement on Windows

Health

YOU'RE NO KID, AND THAT'S NOT ACNE

When Marlane Fairleigh noticed her face had acquired a permanent blush, she bought a drugstore product to treat allergies. But when blushing turned into red bumps that wouldn't go away, the 54-year-old small-business consultant sought out a dermatologist who diagnosed the problem right away: rosacea, an acne-like condition that strikes in middle age.

If you haven't heard of rosacea, you're not alone. The condition is often misdiagnosed or left untreated. But the occurrence of rosacea appears to be on the upswing and may hit one of three fair-skinned baby boomers between the ages of 30 and 50,

according to the National Rosacea Society in Barrington, Ill., an information and physician referral organization (708 382-8971). Even Britain's Princess Diana, renowned for her flawless complexion, may be a sufferer. In a 1992 book, *Royal Fashion and Beauty Secrets*, author Ann Chubb cites "close observers" of Princess Di as saying they have noticed a "trend toward redness and breakouts normally associated with rosacea."

NO CURE. The condition can't be cured, but it can be controlled with oral antibiotics, such as tetracycline, and topical antibiotic creams prescribed by a dermatologist. If rosacea is left untreated, small red bumps resembling pimples will appear. In more advanced states, it can spread to the eyes, causing redness and a feeling of grittiness, and the nose may become swollen, red, and bumpy. Come-

dian W.C. Fields and financier J.P. Morgan are believed to have been two untreated sufferers.

The cause of rosacea is debated. Dr. Jerome Z. Litt, dermatology professor at Case Western Reserve University in Cleveland, believes mites—

vessels near the skin's surface dilate for prolonged periods. A recent survey of sufferers found sun exposure and stress the most common triggers. Others include heavy exercise, hot baths, spicy food, and menopause. Fairleigh, who lives in Addisonville, Miss., it's a mild weather.

Rosacea is as emotionally disturbing as it is physically uncomfortable. Many sufferers report a loss of self-esteem and some experience full-blown depression. Others fear the condition will be equated with the heavy drinking that is also associated with a red complexion. "I have patients who say, 'I can't go out looking like this,'" says Dr. Torok, a dermatologist in Medina, Ohio. But in most cases, the redness can be brought under control in several weeks, she says, much to the patients' relief. *Susan Chan*

WARNING SIGNS OF ROSACEA

- ▶ Intermittent flushing or redness on cheeks, chin, nose, or forehead
- ▶ Acne-like bumps and pimples, dilated blood vessels
- ▶ Bloodshot eyes, gritty feeling in eyes, small hard bumps on both eyelids
- ▶ Red, bumpy, and swollen nose

DATA: NATIONAL ROSACEA SOCIETY

which are always present on the skin—burrow into facial oil glands and proliferate. But other experts think a tendency toward rosacea is inherited. It occurs most frequently in those of Celtic descent.

One thing doctors agree on: Rosacea flares up when blood

complexion. "I have patients who say, 'I can't go out looking like this,'" says Dr. Torok, a dermatologist in Medina, Ohio. But in most cases, the redness can be brought under control in several weeks, she says, much to the patients' relief. *Susan Chan*

Smart Money

RANSOM INSURANCE FOR A MORE DANGEROUS WORLD



Depending on the extent of the coverage, premiums can run from \$1,000 to \$100,000 per year. Usually, companies pick up the tab, but individuals can also buy

the insurance. Basic policies cover ransom payments, the hostage's salary for the period in which he or she is held, and costs associated with hiring a crisis-consulting firm that advises you in the event of a kidnapping. Coverage for accidental death and dismemberment can cost extra, and the premium may vary depending on which countries you visit frequently. (You would pay more if you traveled extensively to Latin America, for example, than to Europe or Japan.)

NEGOTIATOR FEES. From Chubb, insuring one person for payment of a \$10 million ransom could run as low as \$1,000 a year, estimates A. Quentin Orza, a Chubb vice-president. But it could also

rise to \$25,000 for a high-profile person who has been threatened in the past. AIG's policy loaded no-deductible premium will cover expenses up to \$50 million for everything from medical treatment to interpreters to rest and habilitation. It offers an evacuation rider that picks up an additional \$15 million. AIG would not reveal premium costs.

Anyone buying kidnapping ransom insurance should pay particularly close attention to the policy language. It doesn't specify that a certain type of coverage is included, such as negotiator or psychiatrist fees, you may be out of luck when you submit a claim. Also note that it is illegal to purchase the coverage in Germany and Colombia, where governments believe such policies only goad terrorists into action. So if you expect to be transferred to one of those countries, you'll need the insurance before you move. *Chris R*

As U.S. companies expand their business to developing countries in Latin America and the former Soviet bloc, traveling executives have more to worry about than language differences and currency translation. Unfortunately, kidnappings and extortion are on the rise in some of these places.

A small group of insurers, namely Chubb, AIG, and Lloyd's of London, have long offered policies to entrepreneurs and executives that cover ransom demands from kidnappers, both in the U.S. and abroad. But now, insurers have begun to broaden the coverage to include such extras as legal and psychiatric fees and compensation for loss of trade secrets and product tampering. Some of the new policies also reimburse expenses needed to evacuate a country rocked by political instability. Insurance companies are even offering to train executives on how to avoid being kidnapped.

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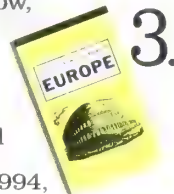
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Want to discuss market trends? Wondering how currency fluctuations are affecting your international holdings? Confused after reading the latest article on the use of derivative securities? If you invest in mutual funds, you can get many questions answered through an 800 number.

Spurred by competition and aided by technological breakthroughs, fund companies have put vast resources into their telephone lines and the people who staff them. "The phones are underutilized," says John Brennan, president of Vanguard Group. "I don't think shareholders understand what a resource they can be."

Service reps can do a lot more than state the current yield on a money-market fund or arrange for transfers among accounts. They have a wealth of data at their disposal and are trained to answer a variety of questions not always related specifically to their funds. "Our people can handle calls as diverse as 'How are you hedging the Swedish krona in a bond fund?' to 'I just inherited \$10,000: What should I do?'" says Christopher Wilson, a Scudder, Stevens & Clark principal who heads customer relations. "We love it when people try to stump us."

DAILY UPDATES. The service isn't limited to the largest fund groups. John Keefe, president of Keefe Worldwide Information Services, estimates that the top 25 to 50 companies all have sophisticated phone Q&A operations. Computers give service reps instant access to account records, fund research, and market data. They can even call up copies of paper correspondence while talking with customers.

Worth Noting

■ **STOCK SCREENER.** Since its Sept. 8 purchase of the *Marketbase* stock-screening program, Morningstar has changed the name and cut the price by more than half. The

Mutual funds

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Initial training—often three to six weeks—includes more than learning how to wade through databases and handle calls efficiently. Staffers gain technical skill in financial markets and learn about the spon-

staying in touch with customers is so important that every manager, even Brennan himself and founder John Bogle, must answer phones for a few days every year.

Officially, reps can't give



sor's entire product line. And they must pass a two-hour and 15-minute test to obtain a license to sell mutual funds and annuities on the phone.

Phone reps receive daily news summaries and update sheets on funds' use of derivative securities, for example. At many companies, they meet periodically with portfolio managers. This lets reps ask questions about strategy and managers learn about shareholder concerns. Brennan says Vanguard believes

You'll get information, not sales spiels, since the phone reps don't earn commissions

advice—that is, recommend a specific fund—but they are trained to ask investors about their investment needs, time horizon, and risk tolerance. Reps then narrow down the options and send out materi-

als on a few funds. Recently, some companies created video books and computer programs that walk investors through the fund-selection process. Rowe Price first brought a retirement-planning kit in 1989 (updated yearly), then added a software version in 1992, and recently created a guide to developing a diversified portfolio, called *Personal Strategy Planner*.

NO DRONES. You won't find hard sell, because phone reps don't earn commissions on sales. They're trained to listen on an investor's needs, hoping that people who understand their funds will stick with them, says Wilson. It's unlikely you'll talk to a dull one either. Sponsors attract top-caliber people, since phone jobs are seen as stepping stones to more lucrative careers, says Stephen Gilbreath, head of mutual-fund marketing at Putnam Investments.

Investors who just want quick access to account information can call automated 24-hour phone lines that use voice-response technology. Such systems let customers transfer money between accounts, request forms or prospectuses, or check on share prices. T. Rowe Price updated its system last year, improving security by providing personal identification numbers. It allows investors to create "funds to watch" list that automatically provides share prices and other data on funds they select. And a computer link lets them perform these functions through their PC. Plus, they can use electronic mail to correspond with customer reps.

Of course, phone reps are also financial planners or stock brokers, who offer a much broader view of investment options. But fund-company staffers can provide fairly detailed information to help make decisions. Keep in mind that you are paying for the service through your fund expense structure. So if you're not calling the 800 number when you have questions, you're not getting your money's worth. *Amey*

company, which tracks mutual funds, will sell *U.S. Equities on Floppy* for \$995 a year with weekly updates (or \$295 for monthly, \$145 quarterly, and \$55 for onetime updates). The disk provides 200 facts on each of 6,000 stocks. Call 800 876-5005.

■ **INVESTING HELP.** The *Scudder Investor Series* (800 225-2470) is a set of three books and a computer disk covering investing basics and saving for college and retirement. Free to shareholders, the books are \$2.50 apiece for others—plus \$2.50 for shipping.

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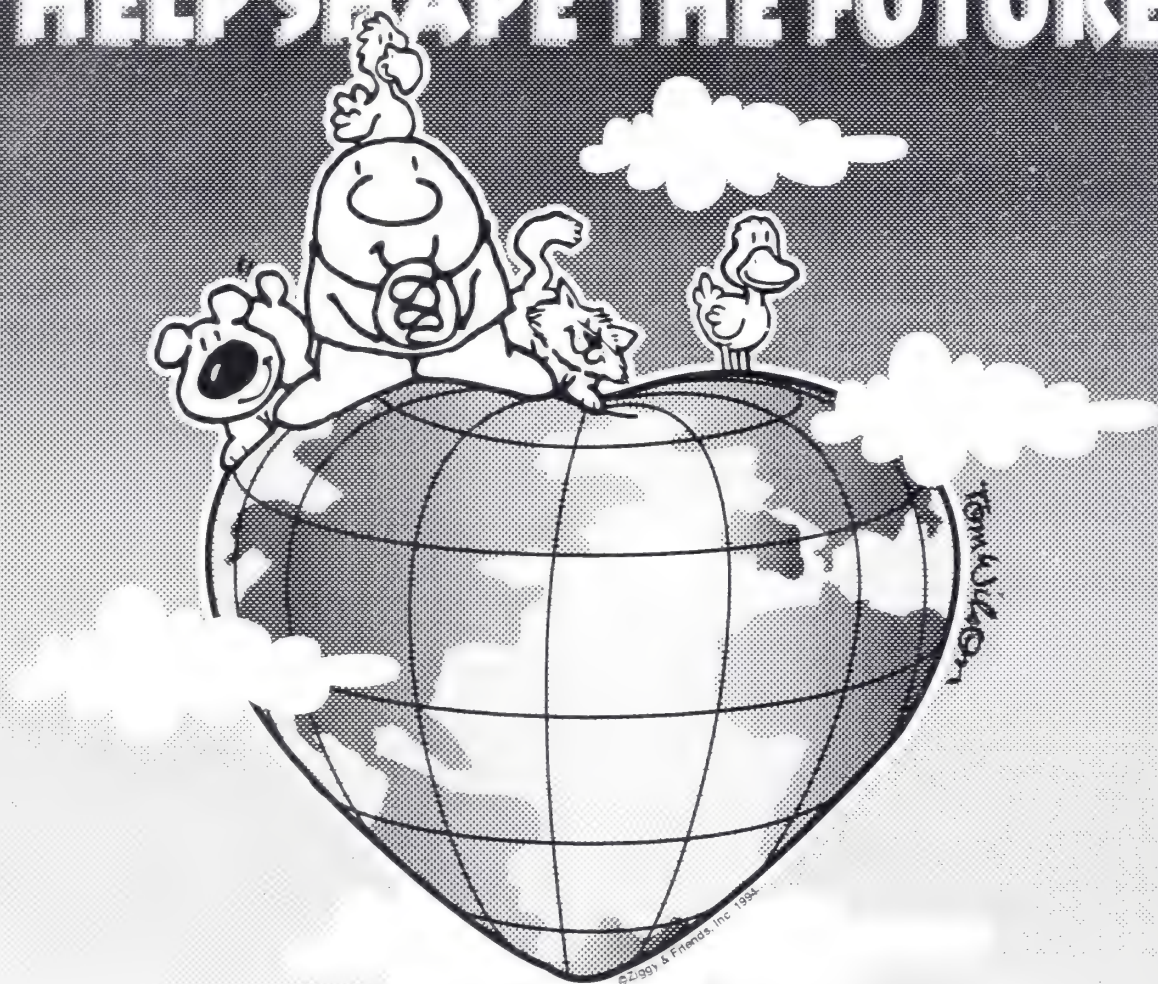
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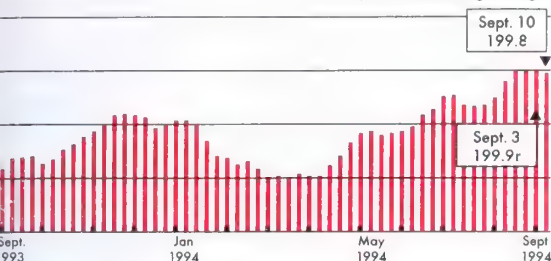


Business Week Index

PRODUCTION

Change from last week: -0.1%
Change from last year: 4.2%

1967=100 (four-week moving average)

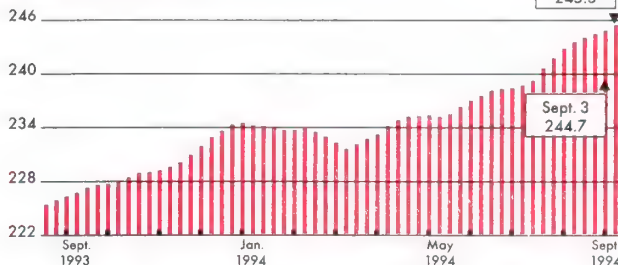


Production index was virtually unchanged during the week ended Sept. 10, as been flat since mid-August. Seasonally adjusted output of autos, lumber, and steel rose sharply, and paper, coal, and crude-oil refining output increased as well. Electric power, and paperboard production fell, while rail-freight traffic declined from the previous week. Before calculation, the index rose to 200.1, revised 199.1.

BW production index copyright 1994 by McGraw-Hill Inc.

LEADING

Change from last week: 0.2%
Change from last year: 8.3%



The leading index increased during the week ended Sept. 10. The growth in materials prices, while still quite strong, was slightly below its pace of the previous week. Lower stock prices, higher bond yields, and slower M2 growth also suggested less economic growth ahead. The growth rate for real estate loans rose and business failures declined. Before calculation of the four-week moving average, the index was basically unchanged at 246.0.

Leading index copyright 1994 by Center for International Business Cycle Research

PRODUCTION INDICATORS

	Latest week	Week ago	% Change year ago
STEEL (9/17) thous. of net tons	1,737	1,781#	-5.3
TRUCKS (9/17) units	134,945	111,874r#	24.6
RAIL (9/17) units	119,471	104,113r#	14.4
ELECTRIC POWER (9/17) millions of kilowatt-hours	63,823	59,863#	8.0
CRUDE OIL REFINING (9/17) thous. of bbl./day	14,066	14,403#	1.5
IRON (9/10) thous. of net tons	19,095#	20,949	8.9
STEEL (9/10) thous. of tons	884.1#	904.2r	6.5
COAL (9/10) thous. of tons	832.0#	832.0r	2.8
WHEAT (9/10) millions of ft.	398.5#	474.1	2.4
TRUCKS (9/10) billions of ton-miles	22.0#	24.7	8.9

#American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, Petroleum Institute, Energy Dept., American Paper Institute, WWPA, SFPA, Association of American Railroads

CURRENCY EXCHANGE

	Latest week	Week ago	Year ago
YEN (9/21)	98	99	106
MARK (9/21)	1.55	1.54	1.65
POUND (9/21)	1.58	1.57	1.50
FRANC (9/21)	5.29	5.27	5.75
DOLLAR (9/21)	1.34	1.35	1.32
FRANC (9/21)	1.28	1.28	1.44
PESO (9/21) ²	3.401	3.411	3.117

¹Major New York banks. Currencies expressed in units per U.S. dollar, except for British pounds expressed in dollars

COMMODITIES

	Latest week	Week ago	% Change year ago
WHEAT (9/21) \$/troy oz.	394.900	390.300	11.4
CRAP (9/20) #1 heavy, \$/ton	134.50	134.50	19.6
COFFEE (9/20) index, 1967=100	211.5	215.3	0.3
COFFEE (9/17) c/lb.	124.5	121.3	39.8
COFFEE (9/17) c/lb.	77.5	75.8	47.6
COFFEE (9/17) #2 hard, \$/bu.	4.04	3.99	20.6
COFFEE (9/17) strict low middling 1-1/16 in., c/lb.	72.78	72.54	34.2

London Wednesday final setting, Chicago market, Knight-Ridder Commodity Research, Kansas City market, Memphis market

in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment in Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

LEADING INDICATORS

	Latest week	Week ago	% Change year ago
STOCK PRICES (9/16) S&P 500	469.70	471.74	2.0
CORPORATE BOND YIELD, Aaa (9/16)	8.32%	8.22%	24.9
INDUSTRIAL MATERIALS PRICES (9/16)	107.6	107.1	13.6
BUSINESS FAILURES (9/9)	304	326	-9.5
REAL ESTATE LOANS (9/7) billions	\$439.2	\$438.2	5.6
MONEY SUPPLY, M2 (9/5) billions	\$3,559.9	\$3,563.2r	1.9
INITIAL CLAIMS, UNEMPLOYMENT (9/3) thous.	330	333	2.5

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of large companies), Federal Reserve, Labor Dept. CIBCR seasonally adjusts data on business failures and real estate loans

MONTHLY ECONOMIC INDICATORS

	Latest month	Month ago	% Change year ago
HOUSING STARTS (August) annual rate, thous.	1,442	1,413r	9.3
INDUSTRIAL PRODUCTION (August) total index	118.5	117.7r	6.7
CAPACITY UTILIZATION (August)	84.7%	84.3%r	4.1
RETAIL SALES (August) billions	\$186.6	\$185.1	7.1

Sources: Commerce Dept., Federal Reserve, Census Bureau

MONETARY INDICATORS

	Latest week	Week ago	% Change year ago
MONEY SUPPLY, M1 (9/5)	\$1,155.9	\$1,154.9r	4.9
BANKS' BUSINESS LOANS (9/7)	299.2	300.2r	10.3
FREE RESERVES (9/14)	498	505r	1409.1
NONFINANCIAL COMMERCIAL PAPER (9/14)	148.9	149.4	-5.7

Sources: Federal Reserve (in billions, except for free reserves, which are expressed for a two-week period in millions)

MONEY MARKET RATES

	Latest week	Week ago	Year ago
FEDERAL FUNDS (9/20)	4.70%	4.64%	3.12%
PRIME (9/21)	7.75	7.75	6.00
COMMERCIAL PAPER 3-MONTH (9/20)	5.01	4.95	3.16
CERTIFICATES OF DEPOSIT 3-MONTH (9/21)	5.04	4.95	3.11
EURODOLLAR 3-MONTH (9/16)	4.94	4.88r	3.08

Sources: Federal Reserve, First Boston

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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

Acer 8
Aeromexico 100
AIG 132
Alax Adhesives 121
Aladdin Industries 12
American Funds Group 110
America Online 8
Andersen Consulting 54
Apple Computer 12, 20, 88, 94
Aranson & Fogler 110
Arthur D. Little 117
Astra 76
AST Research 8
AT&T 12, 110, 116
Axis 56
Avon 94

B

Banco da Bahia 66
Bankers Trust 62
Bank of America 18
Bank of Boston 62
Bell Atlantic 116
BellSouth 117
Bergen Brunswig 94
BioChem Pharma 76
Blackbuster 86
BMG 110
Booz, Allen & Hamilton 94
Brasilar Financial Services 66
Brazil Warrant 66
Brewers Retail 88
Bundesbank 142

C

Canadaigua Wine 116
Capital Cities/ABC 56
Capital Research & Management 110
Carmike Cinema 54
Carter Hawley Hale Stores 128
Caterpillar 57
CBS 56, 86
Central Europe Trust 100
Chevy Chase Federal Savings Bank 22, 122
Chris-Craft Industries 86
Chubb 132
Cimtek 26
Citibank 18, 122, 142
Claris 88
Cleveland Electric 58
Coca-Cola 54, 88
Compagnie Financière de Paris 100
Compaq Computer 8, 12, 66, 88
Computer Intelligence InfoCorp. 94
Creative Artists Agency 54
Crown Books 6
CS First Boston 100
Cupep 73

D

Dallas Cowboys 56
Dart 6
Dataquest 88
Dayton Hudson 128
Dean Witter 62
Dell Computer 88
DeMarche Associates 110
Digital Equipment 6
Dillard Department Stores 128
Diversified Pharmaceutical Services 78
Duquesne Light 58

E

EDS 116
Eli Lilly 78
Enrollment Technologies 20

F

Federated Department Stores 128
Fidelity Investments 18
Foot, Cone & Belding 56
Forrester Research 94
Fox 56, 86
Franklin Resources 100
Freightliner 57

G

GE 58
GE Capital Services 62
Glaxo 76, 78, 112
GM 56, 66
Goodyear do Brasil 66
Grant Seebeck 12
Green Bay Packers 56
Greenwich Associates 100, 110

H

Hambrecht & Quist 88
HeartSouth Rehabilitation 116
HSI Services 68
Hysea 121

I

IBM 8, 88, 94, 112
Imperial Chemical Industries 78
Intel 88, 94
InterTel 12
I.R.I.S. America 20

J

Jabra 121
Jardine 68
J.C. Penney 128
Johnson & Johnson 88
J.P. Morgan 62, 100, 122

K

Kmart 62

L

Lake States 112
Lehman Brothers 100

Levi Strauss 56
Lloyd's of London 132
Lockheed 12
Logitech 20
Long John Silver's Restaurant 62
Lotus Development 62
Lynch, Jones & Ryan 110

M

Macy (R.H.) 128
Maine Manette 12
Massachusetts General Hospital 117
May Department Stores 128
McDonald's 56
McGraw-Hill 8, 48, 110
MCI 56
McKesson 78
Medco 76
Merck 76
Merrill Lynch 18, 26, 47, 100
Mexpetrol 73
Micron Technology 62
Microsoft 6, 8, 20, 62, 88, 94
Microtel 116
MMS International 48
Morgan Stanley 26, 100
Morningstar 134
Motorola 73
Musicom 6

N

National Commercial Bank (Jamaica) 100
National Power 100
NationsBank 122, 125
NatWest Securities 128
NBC 86
NEC 73
NetCom 8
News Corp. 56
New York Giants 56
New York Telephone 110
Norand 12
Nordstrom 6, 128
North Coast Energy 12

O

Ohio Edison 58
Optical Radiation 116
Oracle 62
Owens-Corning Fiberglas 121

P

Pacific Bell 110
Packard Bell 8
Paramount Communications 12, 86
Pathmark 62
Paul Schullman 56
PCS Health Systems 78
Pemex 73
Pennsylvania Power 58
PepsiCo 54
Perry Television 86
Philadelphia Eagles 56
Physician Corp. of America 116
Pioneer Group 100
PNC Investment Management 128

Police & Fire Pension Fund 110
Prodigy 8
Putnam Investments

Q

Quantum Fund 104

R

Ralcorp 116
Ralston Purina 116
Relife 116
Renault 100
Rotech Medical 116

S

Safeway 62
Salick Health Care 15
Salamon Brothers 7
Sanford C. Bernstein
Scudder, Stevens & Clark 134
Shared Medical Systems 116
Shawmut National
Shoppers Food Warehouse 6
S-K-I 116
Smith Barney 57
Smith-Kline Beecham
Sony 86
Soros Fund Management 104
Standard & Poor's 110

Sugarco Mountain
Symbol Technologies

T

Telxon 12
Texaco 56
Time Warner 86
Tollco Edison 58
Trak Auto 6
Tri-County Health Systems 117
Triarc 62
Tribune 86
Tsim 94
T. Rowe Price 134
Twentieth Century Funds 110

U

United Paramount Network 86

V

Vanguard Group
Viacom 12, 86
Vietnam Opportunity Fund 100
Visa 18
Visioneer 20

W

Wal-Mart Stores 1
Warner-Lambert 7
WB Network 86
Wellcome 78
Westinghouse Electric
Wetnam Research 0

Z

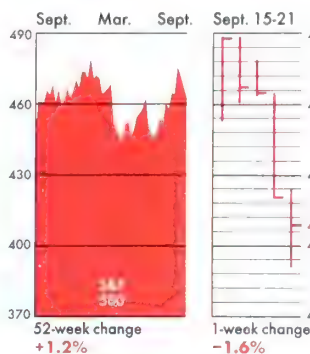
Zeneca Holdings

Investment Figures of the Week

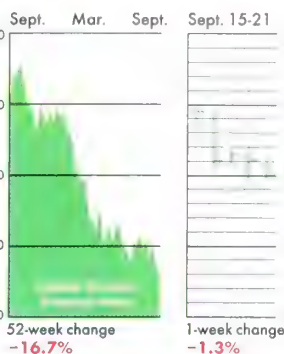
FINANCIAL

planning yet another short-term interest rates? Bond investors certainly like it will. Bond prices, forcing the yield on U.S. Treasury bond to a level in more than two weeks took a pounding as Sept. 20, the Dow Jones dropped more than 67 points, the worst hit in six months. Stocks doing well of late that benefit from inflation as gold mining, aluminum, and paper.

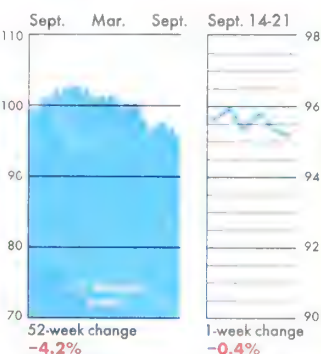
STOCKS



BONDS



THE DOLLAR



MARKET ANALYSIS

INDEX	Latest	% change Week	% change 52-week
DOW JONES INDUSTRIALS	3851.6	-1.1	8.6
COMPANIES (S&P MidCap Index)	173.8	-1.3	0.9
COMPANIES (Russell 2000)	254.4	-1.2	3.2
COMPANIES (Russell 3000)	265.8	-1.5	0.6

INDEX	Latest	% change (local currency) Week	% change 52-week
FINANCIAL TIMES 100)	3014.8	-2.1	0.2
NIKKEI INDEX)	19,885.4	-0.2	-1.4
TSE COMPOSITE)	4358.6	0.3	10.2

FUNDAMENTALS

	Latest	Week ago	Year ago
90-DAY TREASURY BILL YIELD	4.91%	4.68%	2.98%
30-YEAR TREASURY BOND YIELD	7.80%	7.67%	6.09%
S&P 500 DIVIDEND YIELD	2.75%	2.71%	2.76%
S&P 500 PRICE/EARNINGS RATIO	18.3	18.6	23.6

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 26-week moving average	461.0	460.9	Positive
Stocks above 26-week moving average	40.0%	42.0%	Neutral
Speculative sentiment: Put/call ratio	0.41	0.39	Positive
Insider sentiment: Vickers sell/buy ratio	1.17	1.07	Positive

BLOOMBERG FINANCIAL MARKETS, BRIDGE INFORMATION SYSTEMS INC.

INDUSTRY GROUPS

MONTH LEADERS	% change		Strongest stock in group	% change		Price
	1-month	12-month		1-month	12-month	
MINING	15.9	18.7	PLACER DOME	20.1	27.9	24 3/8
MINING	11.7	30.8	REYNOLDS METALS	15.1	23.7	56 1/8
MINING	10.1	49.9	ASARCO	16.6	87.1	32 1/2
MANUFACTURED HOUSING	10.1	11.0	FLEETWOOD ENTERPRISES	10.4	6.3	25 1/4
CONTAINERS	9.9	40.7	STONE CONTAINER	20.4	146.3	20 3/8

MONTH LAGGARDS	% change		Weakest stock in group	% change		Price
	1-month	12-month		1-month	12-month	
AIRLINES	-8.5	-21.3	SOUTHWEST AIRLINES	-15.7	-32.1	22 3/4
FINANCE BROKERS	-8.0	-13.7	MARSH & MCLENNAN	-9.0	-14.2	77 3/8
TELECOM COMPANIES	-6.8	-30.8	NIAGARA MOHAWK POWER	-23.0	-51.0	12 1/8
TRANSPORTATION SERVICES	-6.3	8.0	FEDERAL EXPRESS	-13.2	1.9	60
APPAREL RETAILERS	-4.7	2.2	GAP	-16.1	35.6	35 3/4

MUTUAL FUNDS

Total return		LAGGARDS	
	%	Four-week total return	%
AMERICAN STRATEGIC INVESTMENTS	13.9	DFA JAPANESE SMALL COMPANY	-6.4
AMERICAN ASSOCIATED	13.0	DREYFUS EDISON ELECTRIC INDEX	-5.5
AMERICAN AMERICA HARTWELL EMERG. GR. A	12.6	T. ROWE PRICE JAPAN	-4.8
Total return		52-week total return	
	%		%
AMERICAN STRATEGIC INVESTMENTS	73.3	MONITREND GOLD	-35.3
AMERICAN EMERGING MARKETS INSTL.	54.3	STEADMAN OCEANOGRAPHIC TECHNOLOGY	-29.2
AMERICAN STANLEY INSTL. ASIAN EQUITY	47.7	AMERICAN HERITAGE	-24.9



RELATIVE PORTFOLIOS

Amounts at the present \$10,000 one year ago portfolio	Foreign stocks	Gold	U.S. stocks	Money market fund	Treasury bonds
Relative returns	\$11,873 -0.44%	\$11,034 +1.10%	\$10,520 -0.89%	\$10,205 +0.05%	\$9,023 0.00%

This page is as of market close Wednesday, Sept. 21, 1994, unless otherwise indicated. Funds include S&P 500 companies only; performance and share prices are as of market close.

Sept. 20. Mutual fund returns are as of Sept. 16. Relative portfolios are valued as of Sept. 20. A more detailed explanation of this page is available on request. r = revised

BRINGING ECONOMIC DEMOCRACY TO HAITI

Almost anything Mexico makes, Haiti can also make. Therein lies the economic salvation of one of the world's poorest countries. But before Haiti can gain a foothold in the modern global economy, it must democratize its economy as well as its political system (page 50). Unless Haiti's economic oligarchs are curbed along with its generals, crony capitalism will continue to impoverish Haitians, driving many to the shores of Florida.

The good news is that there is room for cautious optimism. A thriving *maquiladora*-type of assembly industry employing up to 80,000 people existed before the U.S.-imposed embargo. Revived, it can be used as an engine of economic growth, as in Mexico. Haiti's large expatriate community is also a major plus. Many are professionals, others are small-scale entrepreneurs. As in China, expatriates can provide skills, capital, and overseas contacts to foster economic growth. Finally, Haiti's farmers own their land. Irrigation can enable Haiti to export fruits and vegetables, like Chile.

The bad news is that a small number of families have an economic stranglehold on Haiti. Eschewing investment in the country in favor of sending capital overseas, they have used the state to create an insular, protected, no-growth economy, where contacts, not markets, dominate.

This must stop. Washington can lift the embargo and rebuild the infrastructure, but in the end, it will have to help free Haiti's people to practice the entrepreneurial activities for which they are justly known.

DON'T LET LATIN AMERICA SLIP AWAY

The Clinton Administration has managed to set the stage in Haiti for the return of duly elected President Jean-Bertrand Aristide. But the bright lights of a news conference should not blind the President to the fact that his foreign policy team remains inadequate and his approach to Latin America confusing.

Messrs. Carter, Powell, and Nunn pulled President Clinton's chestnuts out of the fire just before his waffling was about to force him to enact an international farce—the sending of a U.S. armada to defeat three small-time thugs.

There has to be a better way. For starters, it's clear that the weight and respect of Clinton's three emissaries were key to the compromise agreement reached in Haiti. The President must get these kinds of individuals—if not the three men themselves—inside his Administration.

The White House must also move away from its ad hoc approach to making foreign policy for Latin America. The President won big on NAFTA, and Washington should focus on expanding the pact south. Yet while Chile once hoped for quick inclusion, the Clinton Administration has made its en-

try more difficult by giving up fast-track trade legislation in exchange for easier passage of the General Agreement on Tariffs & Trade. It's a long time from May to September, while Clinton may have had to dump fast track for GATT. In any case, it is only because he failed to build a political consensus for it in the spring.

Latin American countries are already hedging their bets. Chile belongs to the Asian-Pacific Economic Cooperation group and trades more with Japan than with the U.S. Argentina is moving toward Brazil in a new economic union, Mercosur, which is cutting deals with Europe. Indeed, Washington appears almost unaware of the October Brazilian election, where centrist Fernando H. Cardoso may win the presidency and set the \$500 billion economy on a new course of rapid growth.

A Western Hemispheric summit is scheduled for December. Washington has until then to learn two lessons: Reformed diplomats and clear, consistent strategies are critical to executing foreign policy.

NO LACK OF CAPITAL IN THIS GLOBAL RECOVERY

It's the hottest buzz in world financial circles. From the Bundesbank to Citibank, the really big issue of the moment is whether or not there is a global capital shortage. If there is, interest rates, already rising, may jump and choke off growth. If not, the world economy, now building steam in Europe, Asia, and Latin America, will chug along generating jobs, income, and lots of trade (page 100).

So far, the debate has centered around the demand for supply of capital. Is there enough capital to meet the soaring demands of China, India, Mexico, and Russia, as well as the Group of Seven industrial countries?

The real issue, however, involves not simply the quantity of capital but its delivery. This global recovery is different from all others because of the prominent role private capital markets are playing in financing growth, particularly in emerging markets. Where there are new, creative ways of moving capital, capital is being delivered. Where there aren't, capital stops flowing and economic growth stalls.

Take the rise of new capital markets around the world. Russia, Americans and Europeans are investing some \$500 million a month in new equities. Stock markets in the U.S. trade billions a year, and the combined value of equities in Latin American *bolsas* comes to nearly \$500 billion.

The U.S. mutual-fund industry is investing billions of dollars globally. Four Vietnam funds have combined assets of \$260 million—not bad for a country with no stock exchange.

But as private capital moves into markets around the world, investors want more protection. They need higher disclosure standards and greater transparency of balance sheets. This is as true for U.S. pension institutions as it is for Chinese and Russian individual investors. Delivering capital efficiently requires knowing the risks to calculate the return. Right now, there is no capital shortage for any country wanting to do just that.

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Inside

FIDELITY

How its stock-picking machine works

PAGE 88



TOP FUND MANAGERS

(clockwise from left)
Jeffrey Vinik,
Beth Terrana,
George
Vanderheiden

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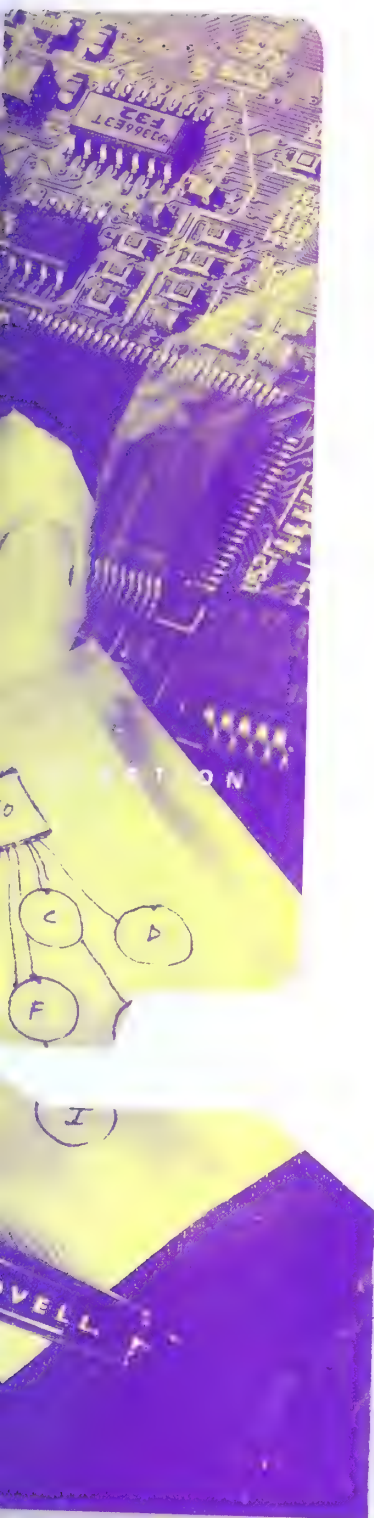
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The collage features several elements: an HP logo and 'HEWLETT PACKARD' text in the top left; a Microsoft employee ID card for Candace Reynolds, OEM, with a photo and handwritten name; an Intel Pentium box in the foreground; and a background image of a computer circuit board. A keyboard is partially visible at the bottom left.



OCT 21

D P C s



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JEFF VINIK'S CANNY MANAGEMENT OF MAGELLAN FUND HELPS MAKE FIDELITY'S FAMILY OF MUTUALS A FORMIDABLE STOCK-PICKING MACHINE

Cover Story

88 INSIDE FIDELITY

How has the Boston fund giant dominated the industry for so long? Smarts and hard work help. Sheer size gives access to top executives smaller outfits can't get. And the corporate culture fosters intense competitiveness, pushing money managers to best their rivals. Can Fidelity funds keep beating the markets forever? Maybe not, but it sure looks like it

96 BONDS? NOT SO FABULOUS

Fidelity fixed-income funds are, well, sort of average

Top of the News

38 NO RESPECT

Clinton getting too little credit for his accomplishments in improving trade and creating jobs?

38 BUSINESS WEEK/HARRIS POLL

Executives lash out at Bill

41 ALL THE PRESIDENT'S ZOMBIES

Washington is filling up with appointees who have lost power but—for some reason—are still around

42 THE STRIKE AT GM

Why it could swiftly put the auto maker in a bind

43 SHRINKING GETS STRATEGIC

The logic of downsizing has changed

44 COMMENTARY

Call for Philip Morris: Don't stonewall the shareholders

46 WASSERSTEIN'S UGLY STEPCHILD

Investors are teed off at the firm's LBO operation

48 NATURAL-GAS PRICES

Nuclear power is one reason prices are dropping

50 THE BAKERSFIELD BASH

A California law firm promotes itself with a star-studded annual event

52 IN BUSINESS THIS WEEK

Community Bankers, DEC reborn, Lotus and Oracle, AIG, McDonnell's new chief, Gap, Lehman housecleans

International Business

58 U.S.-JAPAN RELATIONS

How Washington might successfully attack the trade deficit

62 AUTOS

Is the jinx finally off Jaguar?

66 INTERNATIONAL OUTLOOK

Chrétien's economic high-wire act

Economic Analysis

26 ECONOMIC VIEWPOINT

Becker: Leveling baseball's field

30 ECONOMIC TRENDS

Exports to Japan, tax incentives, wage pressures, Britain's job growth

35 BUSINESS OUTLOOK

The Fed holds steady—for now

Government

57 WASHINGTON OUTLOOK

The fire over illegal immigrants

106 IRAs, THE MIDDLE-CLASS TAX CUT

Why individual retirement accounts may be expanded



RUSSIA'S NEW CAPITALISM:
DESPITE THE CHAOS, THOUSANDS OF
COMPANIES, SUCH AS ONE STARTED BY
CLOTHING MANUFACTURER
ALEXANDER PANIKIN, ARE EMERGING

COMMENTARY

The GOP's campaign pledge: Bad
math, smart politics

Special Report

RESCUING RUSSIA

While the state sector crumbles and
millions could be laid off, private
enterprise is forging a new economy

Entertainment

IT'S NOT ONLY ROCK 'N' ROLL

The Rolling Stones' *Voodoo Lounge*
tour is the archetypal virtual
corporation

Marketing

WHY P&G IS SHINING

Ed Artzt's brutal streamlining and
"value pricing" have boosted profits

Finance

MUTUAL FUNDS' WILD QUARTER

Many went from darlings to losers
and vice versa

INSIDE WALL STREET

Nine West: Still stalking U.S. Shoe?
The makings of a dynamic bank duo
Medaphis: Now, that's managed care

INVESTMENT FIGURES OF THE WEEK

The Corporation

RJR-BORDEN REGRETS

Shareholders fear that KKR's buyout
has only one clear winner: KKR



42 A LITTLE TOO LEAN AND MEAN?
THE UAW GOES ON STRIKE AT A
GENERAL MOTORS PLANT IN FLINT,
MICH., AS DOWNSIZING COLLIDES
WITH INCREASED SALES

112 THE CURDLING OF DAIRY MART

A management feud and richer
rivals have clobbered the chain

Sports Business

114 IS THIS THE OLYMPIC SPIRIT?

The bad blood between the USOC
and the Atlanta Paralympics
spills into court

Information Processing

22 TECHNOLOGY & YOU

In choosing a computer, it's the
monitor that matters



38 WHY BUSINESS HATES CLINTON:
QUESTIONS OF CHARACTER AND
LEADERSHIP FAR OUTWEIGH SUCH
VICTORIES FOR CORPORATE AMERICA
AS NAFTA, GATT, AND CHINA TRADE



110 THE GRUMBLING OVER RJR-BORDEN:
RJR'S MIKE HARPER WILL NOT ONLY
INHERIT BORDEN'S BRANDS BUT ALSO
A BATCH OF INVESTORS WHO INSIST
THEY'RE LOSING OUT ON THE DEAL

116 GOOD INTENTIONS AT THE FCC

An auction that aids small fry won't
stop wireless-industry consolidation

The Workplace

122 COMMENTARY

The U.S. is still cranking out
lousy jobs

Science & Technology

124 INDUSTRY'S NEW HUM

Energy-saving variable-speed electric
motors finally catch on

128 DEVELOPMENTS TO WATCH

Virtual video, a circuit probe, plant
fungi, kidney stones, BeeperKid

Personal Business

130 BONDS: Munis are looking good

MONEY: Insuring your home office

HOME: Asset-integrated mortgages

ELECTRONICS: Vacuum tubes return

Features

6 UP FRONT

12 READERS REPORT

16 CORRECTIONS & CLARIFICATIONS

18 BOOKS

Ingrassia and White: *Comeback*

135 BUSINESS WEEK INDEX

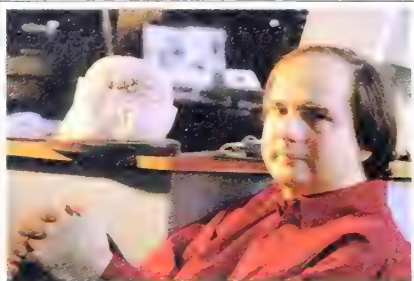
136 INDEX TO COMPANIES

138 EDITORIALS

Why Clinton has business fuming
The real hero of Russia's turnaround

Up Front

EDITED BY LARRY LIGHT AND JULIE TILSNER



HILLIS: Will the general follow the troops?

MIGRATIONS

SUN PICKS THINKING MACHINES' BRAINS

Last spring, Sun Microsystems spurned supercomputer pioneer Thinking Machines' pleas for a buyout. Its finances exhausted by a decline in government purchases, Thinking Machines, based in Cambridge, Mass., filed for Chapter 11 on Aug. 18. So what company is now negotiating a license to Thinking Machines' parallel technology and gobbling up the company's top programmers and designers?

The transfer of key parallel-processor technology to Sun could be announced by mid-October. Sun has already hired 40 former Thinking Machines employees—one-fifth of its workforce today. That includes senior computer architect Gregory Papadopoulos and director of advanced software David Douglas. Most of the flock is now nesting at Sun's Parallel Open Systems Group in Chelmsford, Mass.

The star holdout: Danny Hillis, Thinking Machines' chief scientist. Hillis has removed himself from the licensing negotiations—a sign, say staffers, that he may also be talking to Sun about a position there. Sun declined to say if Hillis would join the company, and Hillis was unavailable for comment.

After emerging from bankruptcy, Thinking Machines expects to focus on software and services. *Gary McWilliams*

WHEELER-DEALERS

DEEP POCKETS CAN'T SAVE BLECH'S BIOTECH EMPIRE

When D. Blech & Co. closed its doors on Sept. 23, the event ended a costly, two-year struggle by financier David Blech to shore up his vast biotechnology holdings. Blech had laid out massive amounts of his own money. But the stock prices in his startup ventures kept falling, and ultimately, his company couldn't meet capital requirements.

Since early 1993, according to government documents, Blech paid out \$55 million to prop up prices of "Blech companies," many of which he had helped form. Unfortunately, Wall Street perceived the payoff of these fledgling out-

fits to be too far distant. Take Microprobe, into which he poured almost \$3 million, starting in April, 1993. It dropped from \$5.56 per share

to 37¢ on Sept. 28. Says Samuel Waksal, CEO of biotech company ImClone Systems: "Putting his finger in the dike didn't work."

One reason for the rescue attempt: Some of his stock was evidently used as collateral for loans. When the value of collateral drops, a lender often calls a loan. That happened last spring, when Blech had to sell stock to pay a Citibank loan said to be about \$40 million. Blech and the bank wouldn't comment.

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TALK SHOW

I'm being clitorized by Time Warner.

—CNN chief Ted Turner, comparing female circumcision to CNN shareholder Time Warner's blocking his attempts to buy NBC

BALLPARK FIGURES

TOO MANY BUCKS FOR THE BUCS?

The seemingly endless baseball strike is hitting especially hard at a handful of teams: those up for sale. Four are officially on the block: the California Angels, Oakland Athletics, San Diego Padres, and Pittsburgh Pirates. The Minnesota Twins say they are not out hustling the club but

investment firm. So the sale teams indicate they like will wait until the work stoppage is over.

The exception is the Pirates, who are under pressure to sell soon. The team faces Jan. 29 deadline to find a buyer who pledges to keep it in the Iron City. (The date was part of the contract when the current owners bought it.) If no buyer emerges, the owners—a consortium of Pittsburgh institutions ranging from Westinghouse to Carnegie Mellon University—will entertain out-of-town offers. Charlotte, N.C., has expressed interest.

The owners want \$100 million for the Pirates, but that may be pushing it—and not just because of uncertainty about the 1994 season. A huge payroll, debt burdens, and a costly contract with the city-owned stadium have produced \$40 million in losses for the Bucs over the past five years. *Keith L. Alexander*



PIRATES AT PLAY: A deadline looms

are "entertaining offers."

The strike has lopped off around 20% of a team's value, according to Paul Much, an analyst with Houlihan Lokey Howard & Zukin, a Chicago

then to 37¢ on Sept. 28. Says Samuel Waksal, CEO of biotech company ImClone Systems: "Putting his finger in the dike didn't work."

One reason for the rescue attempt: Some of his stock was evidently used as collateral

for loans. When the value of collateral drops, a lender often calls a loan. That happened last spring, when Blech had to sell stock to pay a Citibank loan said to be about \$40 million. Blech and the bank wouldn't comment.

REALITY CHECK

THE SANDWICH GENERATION is what pessimists call middle-aged baby boomers. To their way of thinking, the sandwichers are caught in a vicious, unprecedented financial squeeze, paying astro-

nomical bills. Aging boomers are forking out huge sums to provide for their childrens' college education while also supporting their frail, aged parents. No wonder boomers find it impossible to save.

IN REALITY, the plight of the Sandwich Generation is overblown, according to the Census Bureau. The vast majority of boomer families don't have college-age children, much less dependents in college. In 1989, some 16% of families had at least one child aged 18 to 24—and of these families,



only 39% had at least one child attending college. Similarly, only a small number of the middle-aged have a parent over 80, says the bureau. True, the burden on some of the middle-aged is greater than in 1950, when young people were far less likely to go to college and the old didn't live as long. *Christopher Farrell*



BLECH: Wall Street balked

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DIET COKE: ONE CALORIE, NO BEEFCAKE

Sorry, ladies, the clock is winding down on Lucky Vanous' fame-filled 15 minutes. Seems the topless construction hunk, ogled by female office workers as he downs a Diet Coke, soon may be jobless. Word is that, partly because



LUCKY VANOUS: Endangered hunk

of tough competition from other soft drinks, Coca-Cola plans no sequel in its 1995 commercials. "We will not do things just to make you feel good," says Coke's marketing chief, Sergio Zyman, of the company's marketing philosophy.

CORPORATE IMAGES

THAT SURE IS ONE DEVIL OF A LOGO

The devil, as the saying goes, is in the details. When Arizona Public Service recently brought out a 21-page booklet on ethical standards for its 7,000 employees, the \$2 billion utility chose a snappy



STAR-CROSSED: Some at Arizona Public Service are spooked

logo for it: the figures of two people pointing at a star.

Turns out, though, that Phoenix-based APS has the same problem that Procter & Gamble encountered a few

One reason to squelch the popular TV spot, which debuted in January, is that Lucky could upstage the product. But mainly, a source close to the company says, Coke wants to shift its ads' theme (current slogan: "This is Refreshment") back to the taste of the soda (a previous tagline: "Just for the Taste of It").

The point is to combat teas, designer waters, and fancy fruit drinks that have flooded the beverage aisles, pushing out diet soda. The overall market share for diet soda

fell to 28.2% in late 1993, down from the 1991 peak of 29.8%, says *Maxwell Consumer Report*. While the tasty new products have more calories, they project a natural, health-conscious image. Next year, archrival Pepsi-Cola is expected to offer a new "reduced calorie" soda aimed at Diet Coke. Single-calorie Diet Coke itself has held its own, boosting its share in supermarkets by 1.7% for the 12 months through Mar. 31. Yet the source says Coke fears erosion if it doesn't act. *Maria Mallory*

years ago with its man-in-the-moon logo. Some workers think it closely resembles a satanic symbol and are refusing to take the manual, which spells out APS's rules against everything from conflicts of interest to harming the environment.

Too bad. The company spent months reviewing the manual and had 10,000 copies distributed to 25 different locations. "No matter how hard you work to do things right, there's an importance of knowing the culture within the company," says APS's corporate counsel, Nancy Loftin. Rather than scrap the whole project, APS is verbally describing its policies to those who won't read them. As for next year, the search is on for a new logo. *Linda Himmelstein*

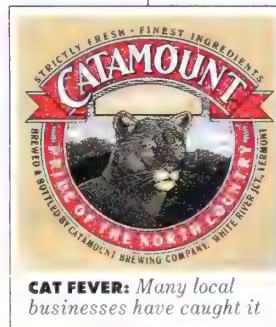
DRAWN AND QUARTERED



TRUE BELIEVERS

WHY THE LION IS KING IN VERMONT

Elsewhere, they are pumas, cougars, or mountain lions. In Vermont, they're called catamounts. For years, Vermonters have used the name on all kinds of businesses. There's Catamount Brewing. And Catamount Auto Parts. And Catamount Landscaping. About 40 such businesses are listed in the Vermont phone books. And the University of Vermont's sports teams are called the Catamounts.



There's only one problem: no official sightings of the long-tailed, 100-pound predators in Vermont since 1881. Oh, some folks claimed to have seen them, but these sightings were written off as ignorance or plain old drunk-

eness. If the storied beasts were roaming the Green Mountains, why were there no tracks, no carcasses, no evidence at all?

In April, however, three catamount-like creatures were spotted bounding through the snow. An analysis of their feces by the National Fish & Wildlife Forensics Laboratory has just verified the good news. The

Green Mountain State now joins Florida as the only Eastern state with confirmed catamount populations. "It was no surprise," says Philip Gentile, marketing director at Catamount Brewin-

g in White River Junction where the brewers have long maintained a bulletin board of reported sightings. Meanwhile, some say, over in Lake Champlain cruises a Loch Ness-style monster name Champ. *Timothy Belkna*

THE BIG PICTURE

The first household for most people is an apartment or rented house. Because a lot of baby boomers have moved on to home ownership, the growth of rental units is slowing this decade. Aside from young singles, current demand is fed by immigrants and the elderly.

DATA: JOINT CENTER FOR HOUSING STUDIES, HARVARD UNIVERSITY



FOOTNOTES

Chinese motorcycle production, in units, in 1987: **0.8 million**. In 1990: **1 million**. In 1993: **3.6 million**



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386-based PCs

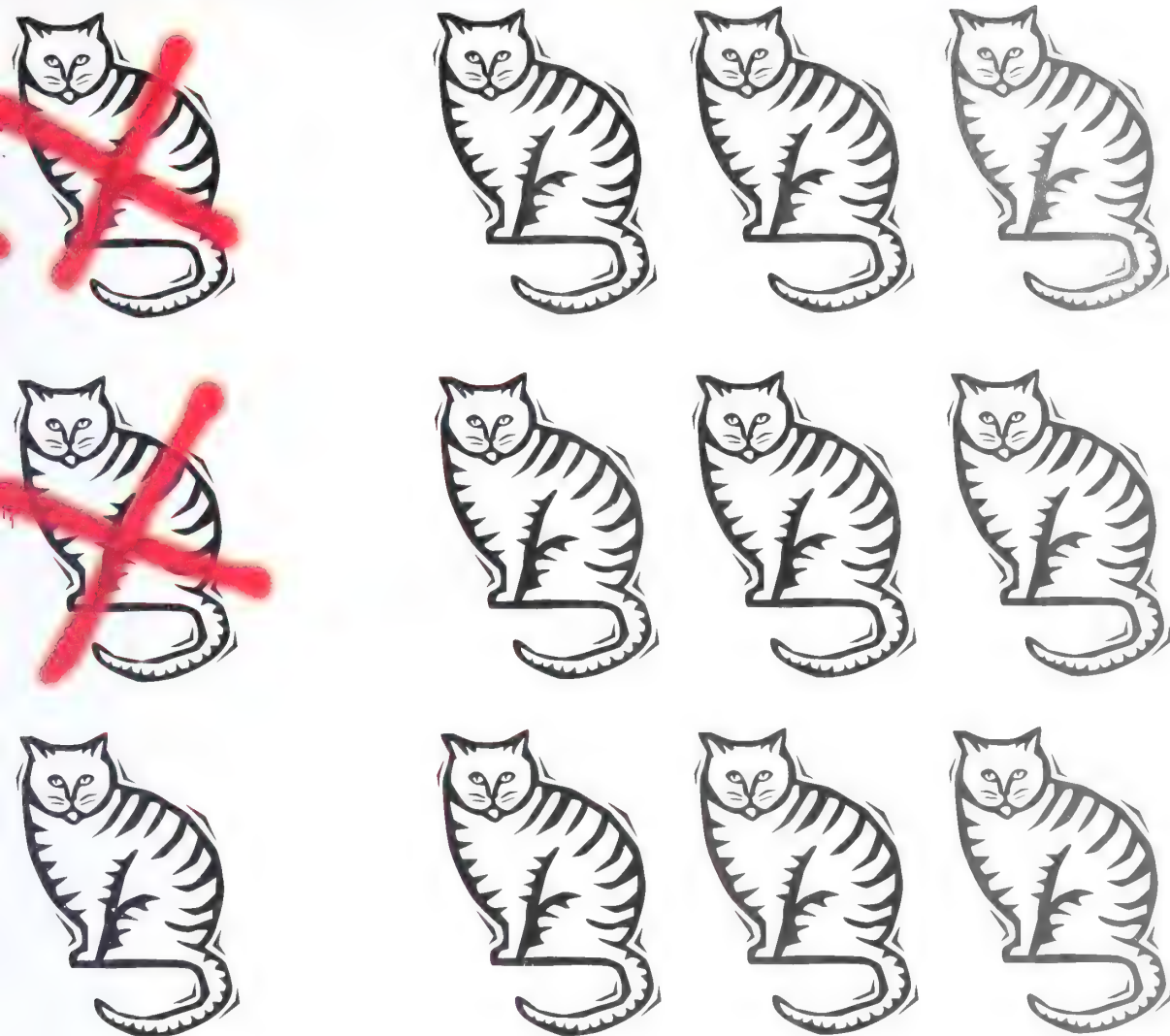
486-based PCs

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HOW TO REALLY PROTECT PENSIONS

Asking corporations to pay more to the Pension Benefit Guaranty Corp. is only going to jeopardize those companies that are trying to survive in today's difficult economy ("Harsh medicine for ailing pension plans," Government, Sept. 19). I suggest that Congress pass a law that gives the pensioner—rather than stockholders and creditors—first claim on the assets of a bankrupt company. That would protect the pensioner and cause stockholders to make sure that corporate pension plans were fully funded.

Robert Wintermeier
Croton, N.Y.

Your article reveals how the public—Congress included—is at the mercy of the PBGC's self-serving analyses. The \$2.9 billion deficit, for example, is puffed: \$1.6 billion is called "net claims for probable terminations," and its addition as a real liability violates the letter and spirit of generally accepted accounting principles. Up to \$1 billion is due to two successive improvements in the PBGC's assumed mortality rates, for which no need was shown. And interest rates have climbed since 1993, when the \$2.9 billion was calculated, evaporating an additional half-billion or so.

We therefore are looking at a phantom deficit. An analysis of the \$53 billion in plan underfunding demonstrates that isn't what the PBGC claims, either. A badly misinformed public is a dubious basis for the passage of the PBGC's pension-reform bill.

David Langer
ChairmanEmployee Benefits Committee
Actuarial Society of Greater New York
New York

Let's put the blame for underfunded pension plans where it belongs: on the U.S. government. Underfunded situations predominately occur in plans for hourly union employees. This is because future negotiated benefit increases are not allowed to be figured in when deter-

mining tax-deductible pension contributions. For salary-based plans, future pay increases are taken into account. Without the tax benefit, there is little incentive to fund hourly plans. The "fix" would be to change the tax law, not to increase PBGC premiums. This would get the money into pension plans, where it belongs. While the Clinton Administration did not create the problem, it would be an error on their part to try curing the symptom and not the disease.

John E. Tebbett
Gurnee, Ill.

DEATH, TAXES, AND REFORM

Your article, "A ghoully debate over cashing in on death" (Top of the News, Sept. 19), missed one aspect of this debate: the tax consequence of accelerating death benefits of life insurance contracts.

Current law generally provides that amounts received under a life insurance contract prior to death are taxable to the extent the amount received exceeds premiums paid. I have long championed legislation that would provide for tax-free treatment of accelerated death benefits and was pleased that it was included in the health-care reform bill reported by the Ways & Means Committee.

The legislation would provide that individuals certified to have a terminal illness or injury that can be reasonably expected to result in death within 12 months can elect to receive the proceeds of their life insurance contracts tax-free. As a consumer protection, policyholder must receive net present value of the death benefit in order to receive favorable tax treatment. This means that insurance companies cannot discount the policies more than inflation.

While it appears unlikely that Congress will complete comprehensive health-care reform this year, I believe this provision, which enjoys broad bipartisan support, should be and will be part of any health-care legislation we enact.

Barbara B. Kennelly (D-Conn.)
House of Representatives
WashingtonBUSINESS WEEK
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ORATE FITNESS REQUIRES MORE 'LIPOSUCTION'

Hamel-Prahalad analogy of business downsizing as "Corporate anorexia" (Books, Sept. 19) would be apt if typical belt-tightening within organizations had been more across-the-board. Alas, the kind of cost-cutting we observe is more akin to corporate liposuction. The surgical removal of fatty tissue would indeed reduce weight and perhaps enhance appearance, but it will not like improve the functioning of the body. A proper diet and a fitness program are keys to revitalization. This is the true responsibility of top management and should be what its vision and action are about. Without a careful attention of the right corporate size, downsize—or restructuring or reengineering—to improve the bottom line (no pun intended) is likely to result in return to the cosmetic surgeon.

Moreover, unless the remaining employees can be convinced that they are muscle and not the fat, any pep talk about empowerment or total quality management will be wasted.

James K. Ho

Professor

Information & Decision Sciences
University of Illinois, Chicago

PHIL MORRIS' MACHO CHIEF: AS COFFIN NAILS

What a public relations coup for Philip Morris, for Philip Morris Cos., its new chief executive, Geoffrey Bible ("A smokin' Marlboro Man," Newsweek, Sept. 19).

Mr. Bible tells it, he goes through a day of the cowboy's friend, a sentiment that no doubt will hearten millions who die each year from tobacco-related diseases. As one tobacco lobbyist in your article puts it: "Nobody wants a wimp to run this company." No wonder Bible's no wimp. Or is the top smokin' his own dope?

Peter Sherwood

Managing Director

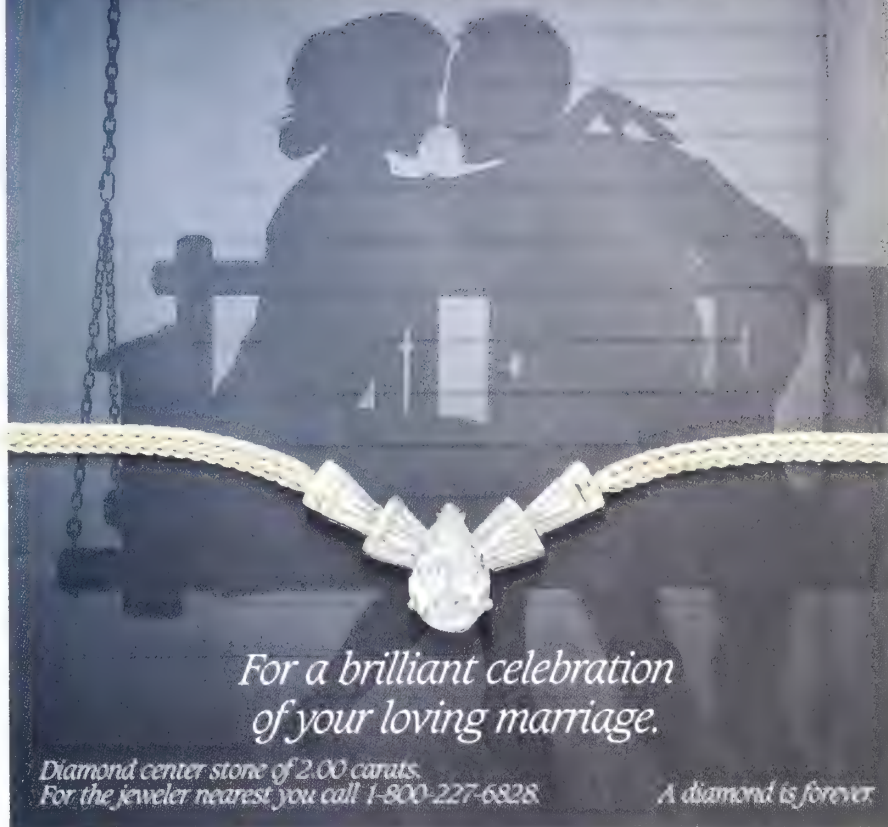
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PHONE RIVALRY KEEPS DISCOUNT RATES DOWN

Our story, "All those long-distance discounts are sweet, but..." (Information Processing, Sept. 19), concludes the major long-distance phone companies—AT&T, MCI, and Sprint—are "funding" their residential discount price plans by raising their basic rates, to the detriment of consumers who do not opt for discount plans. I reach quite different conclusions.

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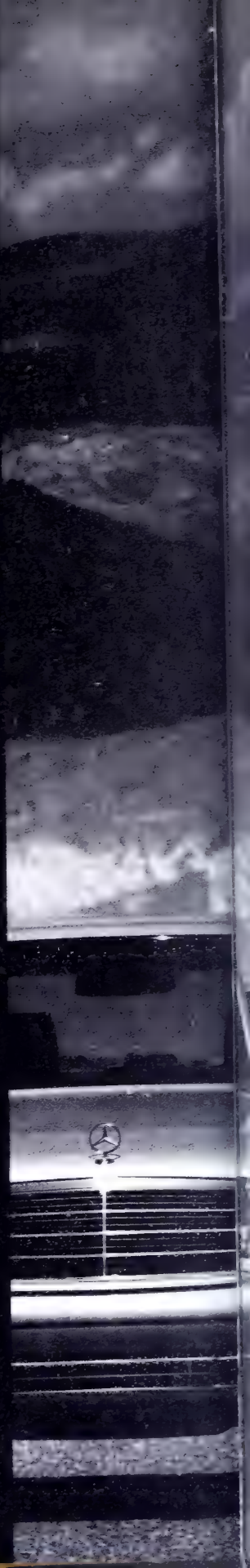
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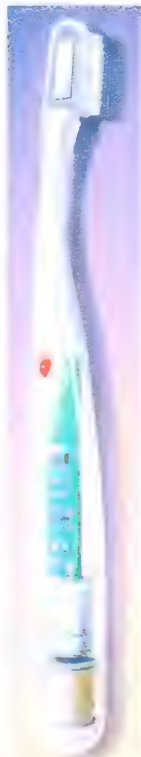
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Readers Report

CORRECTIONS & CLARIFICATIONS

"Survival of the biggest" (Top of the News, Sept. 26) should have described more precisely the deal between American Express Co. and Thomas Cook Group. AmEx bought Cook's corporate travel-management business, which constituted about 10% of Cook's revenues, and its U.S. licensee, Cook, remains a provider of leisure travel services, foreign exchange, and travelers checks.

"Elsie may be ailing, but KKR is thinking whipped cream" (Top of the News, Sept. 26) should have identified the partner at Meridian Consulting Group as Mike Shinall.

"Sprint picks up the pace" (Information Processing, Sept. 5) should have said that MCI outpaced Sprint with second-quarter long-distance revenue growth of 13% to 12.3%, respectively.

Your unstated assumption is that prior to the recent increases, basic rates were cost-based. As those of us who were at the FCC in 1989 know, the maximum price for these rates was set artificially low. Even today, the margins for these services are too low for one-third of the market whose calls total less than \$3 a month. Given monthly subsidy costs for universal service of 52¢ a customer and bill-rendering costs ranging from 33¢ to 88¢ a customer, it's easy to see why a customer who makes few calls does not cover even the direct costs of service.

With the introduction of competition, artificial rate schedules have undergone restructuring. One should not be surprised to see long-distance carriers raising basic rates "virtually in lockstep" as competition drives out the previous regulatory distortions.

Peter K. Pitsch
Pitsch Communications
Washington

THROW THE BUMS OUT, BUT KEEP THE ANTITRUST EXEMPTION

Regarding "Throw the baseball exemption out" (Editorials, Sept. 26), please save your space in editorials for more profound issues of the world economy and leave baseball on the sports pages—at least until you learn more about the business of baseball.

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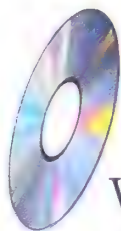
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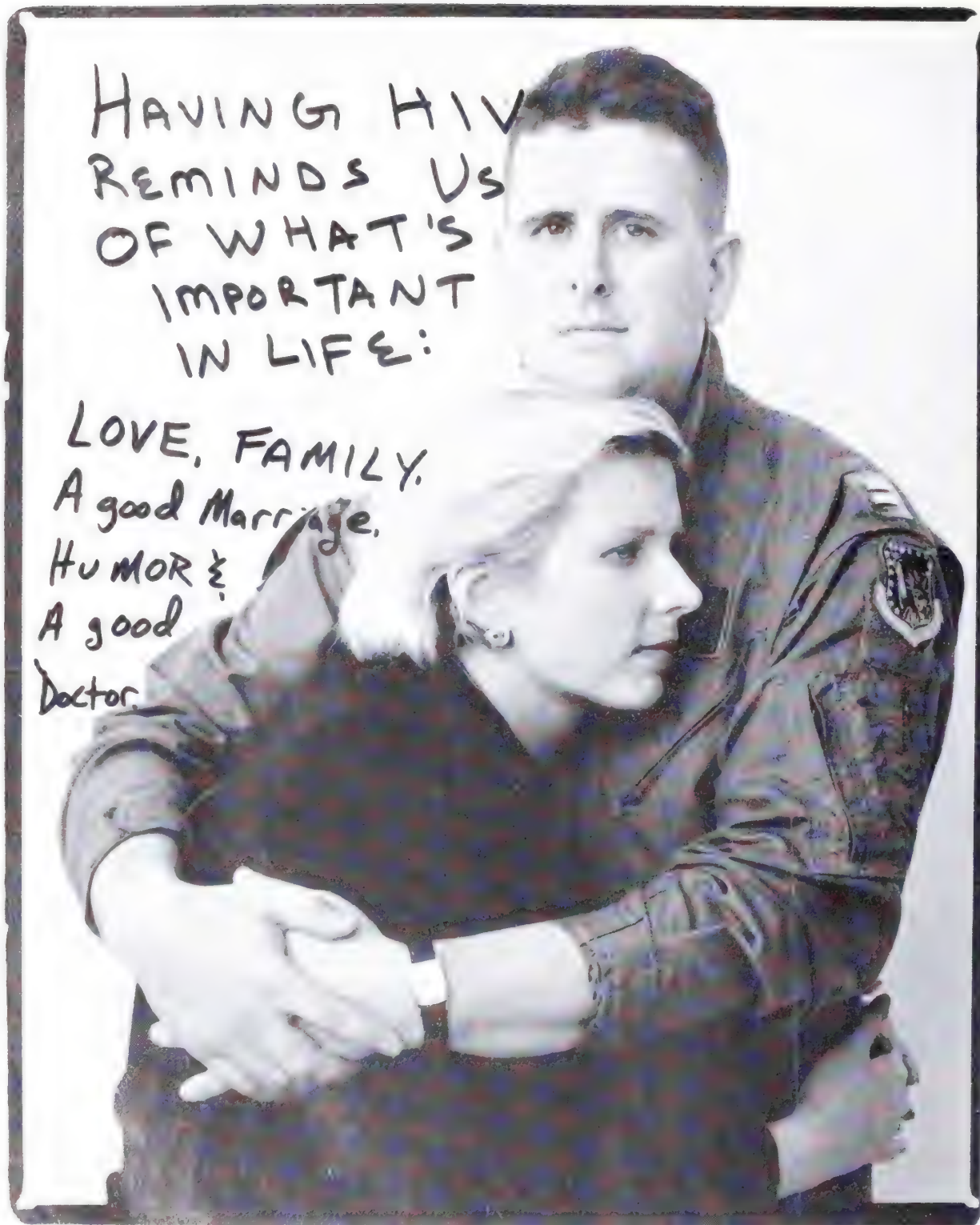
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ball is a business that competes
st other forms of entertainment
s customers (fans) and revenue
television. Competitive balance
s the viability of the enterprise.
us, the salary-cap/revenue-sharing
sal of the owners—even though it
tivated by greed—is pertinent to
ong-term success of the game. The
rust exemption is not.

Maybe Congress should take away
exemption. Will that end the work
age? Probably not. More impor-
will it improve the business of
ball? Definitely not.

Paul King
Belle Harbor, N.Y.

HOW MUCH ADD THE NIXON LIBRARY

Guess whose library is a "snore"
to Front, Sept. 12), BUSINESS WEEK
ted that our esteemed cousins at
Donald Reagan Presidential Library
ni Valley, Calif., attracted 2,300 vis-
to that library's exciting high-tech
show over the weekend of Aug.
while reporting that "the crowds
absent" from the Richard Nixon
ry & Birthplace.

In fact, more than 340,000 people
come to the museum so far this
to pay their respects to the Presi-
and his First Lady and to view
galleries and gardens. During the
end in question, our library had
visitors, and—while we admittedly
short on virtual reality—we offered
al exhibits on Presidential neck-
(as reported in BUSINESS WEEK),
5th anniversary of the landing on
noon, and California Impressionist
ing.

short, Southern California has two
mic Presidential centers, each dis-
y reflective of the energy of a vi-
ry President.

John H. Taylor
Director
Richard Nixon Library & Birthplace
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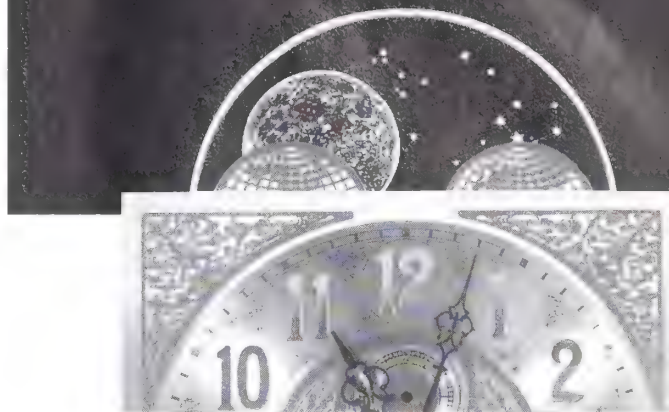
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COMEBACK: THE FALL AND RISE OF THE AMERICAN AUTOMOBILE INDUSTRY

By Paul Ingrassia and Joseph B. White
Simon & Schuster • 496pp • \$25

WHEN DETROIT STOPPED SPINNING ITS WHEELS

During the 1980s, each of the U.S. auto makers came perilously close to disaster, and each found its own way to pull out of the skid. Chrysler Corp.'s brush with death—before it blazed back with an arsenal of hot vehicles—is but the best-known story. As each of the Big Three battled back from the brink, players with Cadillac-size egos struggled to learn new ways to compete.

Comeback: The Fall and Rise of the American Automobile Industry wraps a dozen years of turmoil into a compelling saga. One irony of the turnaround, contend authors Paul Ingrassia and Joseph B. White, is that “while Detroit decimated free trade as a threat to its existence, free trade... saved Detroit by forcing it to improve.” Toyota Corp. and Honda Motor Co. raised the bar on efficiency and quality, while Lexus and Infiniti dramatically improved customer service. Detroit had to follow suit.

The heroes of *Comeback* are the American managers who awoke early to the changing climate and fought for years to get their companies to adapt. The most jarring revelation may be just how many General Motors Corp. managers realized as much as 10 years ago that GM was veering off course but were frozen out by hidebound bosses and peers.

Ingrassia and White, who won a Pulitzer for their *Wall Street Journal* coverage of GM's 1992 management upheaval, spin a yarn that will entertain readers beyond the industry. Yet there is enough fresh information about well-known events to rivet auto insiders. There is, for instance, the untold story of GM executive Robert J. Eaton's unlikely recruitment as Lee A. Iacocca's successor—engineered by his best friend, a Chrysler middle manager.

There are also new details about the abrupt 1989 “retirement” of Ford Motor Co. Chairman Donald E. Petersen. The authors say the darling of the business

press and B-school professors failed to match his behavior—marked by outbursts of temper—to his preachings about enlightened management. He ran afoul of the Ford family and was forced out by his board—though it took separate visits by three directors to get the message across.

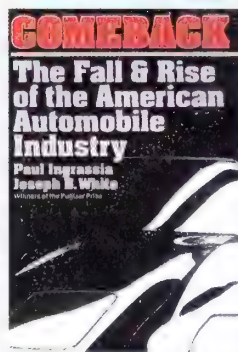
Such personality struggles, White and Ingrassia say, drove as many of the Big Three's major initiatives as rational business plans. Nowhere is the destructive role of rampant ego clearer than in GM Chairman Roger B. Smith's mid-'80s

Smith's blunders and Stempel's dithering rattled GM's board and Wall Street. But there's little about the workers whose lives were shattered.

Comeback is divided into two sections: “Old Lions,” about the postwar generation of managers who never lost the sense of Detroit's invincibility, and “Young Lions,” about the new wave leading Motown's resurgence. The Old Lions get two-thirds of the book—and it's the juiciest part. Woven into the largely familiar history of Detroit's marketing and manufacturing gaffes are entertaining anecdotes about such colorful characters as Lee Iacocca and the “Gang of Ford” who followed him to Chrysler. Here, now-Chrysler President Bob Lutz growling at rival Dick Dauch: “You may be a former football player. But I'm a former Marine, and I'm trained to kill.”

As *Comeback* nears the present, the tales, though enlightening, are less outrageous. The new leaders may lack the swagger of the old guard. And, no doubt, sources were most candid about events safely in the past. Still, the chapter on GM's purchasing czar, Ignacio López de Arriortúa, is disappointingly dry. There's a fascinating chronology of the duplicity involved in his defection to Volkswagen, allegedly with reams of GM secrets. But even though his departure is portrayed as a stunning personal betrayal of his “hero,” current Chairman Jack Smith, there's little insight into why López turned his coat and why

The most jarring revelation? Many GM execs knew 10 years ago that the company was veering off course



spending binges on technology and diversification. The authors also make a gripping tale of GM's 1992 board coups. Former Chairman Robert C. Stempel, often depicted as a victim of leaks by disgruntled directors, is seen here as a guy who stubbornly ignored GM's need for immediate change.

To make sense of 12 years in this complex, rapidly changing industry, the authors focus on a series of key episodes. Individuals—as famous as Iacocca or as obscure as Steve Bera, a middle manager toiling on GM's joint venture with Toyota—figure in stories that exemplify broad trends.

The result is highly readable, though it can't be called comprehensive. Discussion of Japanese carmakers' exploits on U.S. soil is sketchy. And those who really felt the pain of Detroit's follies are conspicuously absent. We read how

no one at GM saw it coming.

Ingrassia and White wind up with stories illustrating how each of Detroit's Big Three is changing. They end on a note of wary optimism about the American auto makers' newfound success and humility, but evince understandable concern about whether the companies will revert to their arrogant, profligate ways.

Chrysler's continuing struggles to improve quality and GM's to master its intransigent bureaucracy certainly warrant caution. Besides, the rising yen and recession in Japan have helped Detroit nearly as much as its own efforts. And recent plot twists—notably Ford's global reorganization—make long-range forecasts risky. This story isn't over yet.

BY KATHLEEN KERWIN

Kerwin is *BUSINESS WEEK's* Detroit bureau manager.



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A black and white photograph of a man, likely a writer, sitting outdoors. He is wearing a dark jacket over a plaid shirt. He is smiling slightly and looking towards the camera. Bare tree branches are visible in the background against a bright sky.



Power over tomorrow

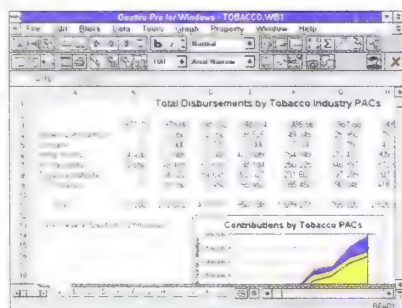
EDITED BY STEPHEN H. WILDSTROM

IT'S NOT THE BOX, IT'S THE MONITOR

Computer shoppers often ask me for advice, and my answer usually surprises them: If you're looking for a machine to run Windows, don't spend a lot of time worrying about the computer itself. Decide if you want a 486-class machine or an even faster Pentium. Look for the best price on a box with eight megabytes of memory and at least a 340-mega-

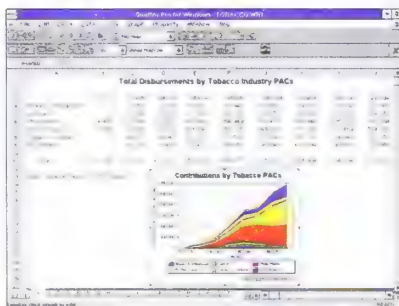
on the screen. A bigger display gives 25 lines of bigger text. But graphic interfaces adjust how much they cram into a window to the size of the display. Bigger screens show you more of a word-processing page or spreadsheet, or the output of several programs at once.

Even so, the best and biggest monitor won't do you much good unless you configure it properly. A video image is made up of thousands of tiny dots, or "pixels," and the key to comfortable viewing is matching the number of pixels to the monitor size. Macs can do this on their own; Windows leaves it up to users to choose the right screen resolution.



MORE BYTES, SAME SPACE

THE TOP IMAGE SHOWS RESOLUTION OF 640 BY 480 PIXELS. AT RIGHT, 1024 BY 768. WITH A HIGHER RESOLUTION, MORE DATA CAN BE DISPLAYED IN THE SAME AMOUNT OF SCREEN AREA



byte hard drive. Then put your effort and as much of your budget as you can into picking a display monitor.

AT THE LOOKING GLASS. There just isn't very much difference between different lines of computers. (That's even truer for Macintosh, where you are limited to Apple Computer Inc.'s offerings.) But you'll spend your computing hours looking at the monitor, which makes it a critical choice.

Graphic-user interfaces such as Windows (and even more so for the upcoming Windows 95) put great demands on displays. Most DOS programs put 25 lines of text

Monitors are growing. The 14-inch size that has been standard for several years is giving way to 15-inch units. Seventeen-inchers are becoming the choice for serious business use. But unless your larger display is set up right, you'll just see bigger, grainier images.

The right resolution depends on your eyes and how far away from the screen you sit. For most users, the standard Windows display—640 pixels wide and 480 pixels high—looks just about right on a 14-inch monitor. Many users are comfortable with the next step up, 800-by-600,

on a 15-inch unit. And the sharp-eyed probably can work at 1024-by-768 pixels on a 17-inch screen.

Of course, there's no point worrying about configuring your monitor until you have bought it, and careful shopping is time-consuming. I find that specifications for "dot-pitch size" and "scan rate" are next to useless in describing monitors' actual performance. You're much better off trusting your eyes and going with your personal preferences.

A PERSONAL CHOICE. For example, some monitors, especially those from NEC Technologies, offer crisp, brilliant images, but at the price of greater susceptibility to glare. Other manufacturers fight glare with coatings that dull the image slightly. Some more expensive monitors use high-tech coatings to improve the trade-off, but in the end, the choice is a matter of taste. Shopping requires looking at as many different monitors in stores as you can. Remember that dealers show monitors under ideal conditions; anything that looks less than perfect in the store will be worse in your home or office.

If you're buying a new monitor, either as part of a new system or to upgrade your old computer, you'll probably want a 17-inch model. Unfortunately, glass-blowing hasn't enjoyed the same manufacturing revolution that has driven down semiconductor prices. Street prices range from about \$750 to about \$1,200. The top-of-the-line units generally offer features, such as precise color calibration, of limited value to most business users, so a midprice unit may be your best bet. Fifteen-inch monitors run about \$400 less.

New software, especially Windows 95, will make it easier for users to tune their displays for best performance. For now, that's still harder than it ought to be. But there's probably no area of computer use where time invested in learning will pay greater dividends. *S. W.*

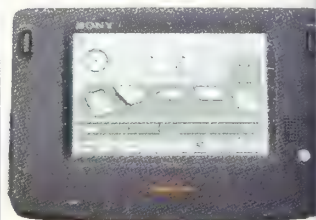
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DIGITAL ASSISTANCE

PUTTING A PDA TO GOOD USE

Since Apple Computer introduced the Newton MessagePad in 1993, the personal digital assistant has been in search of a practical use. Sony's new Magic Link, which began shipping at the end of September, could help give PDAs a reason for being.

The first device built around General Magic's Magic Cap



operating system, the \$1,000 Magic Link was designed as a communications tool for executives and professionals on the go. To enter data into the 1.2-pound device, the user taps an on-screen keyboard with a special pen, or with fingers. For heavier-duty work at your desk, an auxiliary keyboard is available.

Magic Link's real strength is General Magic's Telescript communications software and its connections to AT&T's new PersonaLink network. This hook-up makes it easy to write a message on the Magic Link, then use PersonaLink to dispatch it to the recipient's fax machine, pager, or mailbox on nearly any public E-mail system, including MCmail, CompuServe, or the Internet.

Magic Link's major lack is two-way wireless communications. Its 2,400-baud modem needs a phone line to send data or faxes, although a \$250 credit-card sized accessory lets it function as a pager. Leaving out wireless allowed Sony to escape some of the woes that have plagued Motorola's otherwise similar Envoy, still expected to ship by yearend.

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BASEBALL: HOW TO LEVEL THE PLAYING FIELD

BY GARY S. BECKER



Taxing total spending by teams and imposing a second tax on the worst performers would help small-market clubs and encourage competition—without a salary cap

Since the start of the strike by Major League Baseball players and the premature death of the season, sports writers, TV analysts, and fans have been busy assigning blame and taking sides—without addressing the underlying economic issues and special problems of baseball and other team sports.

The stubbornness and solidarity of owners during the strike have been blamed on the special exemption from antitrust laws granted to Major League Baseball in 1922 by the U.S. Supreme Court. But baseball isn't alone in its immunity to antitrust litigation: The Clayton Antitrust Act of 1914 exempted all unions, including sports unions. And other sports, even those subject to antitrust litigation, have had similar conflicts: Witness the 1987 National Football League players' strike.

The most important distinguishing characteristic of the economics of baseball has nothing to do with antitrust: It is that baseball fans, like fans of other team sports, often care less about the absolute quality of performance by players and teams than about their records relative to the teams they compete against. This consideration differs from those involved in most other products and services. Will the team they root for win a lot of games, make the playoffs, and possibly even win the World Series? Will their favorite batter lead the league, or will a star pitcher win more than 20 games?

A TIGHT RACE. The sensitivity of revenues from attendance and television to relative performance implies that revenues are greater when games are close, races are tight, and perhaps also when the teams that win the World Series or championships in other sports tend to change from year to year. Owners oppose free agency and unfettered competition for rookies, arguing that races would not be close because teams in large markets or with deep pockets would buy up the best free agents and rookies. Yet studies find that the tightness of races and difference in won-lost records have not changed much since baseball went to free agency in 1976.

The importance of relative performance also means that spending by teams can degenerate into an "arms race." Each team alone has an incentive to do a bit more to get a competitive edge, but no team may get an edge on the competition if all spend more. Just as nations can increase their weapons without changing the balance of power, the ranking of teams in a sports race may be unchanged when they all spend more on players, farm teams, scouting, managers, and in other ways.

Owners and players need to find a set of rules that limits spending and encourages competition without tilting the labor-management balance too much to either side. Owners believe the solution is a cap on team salaries, but players correctly perceive that such caps are too rigid.

Strikes and lockouts might occur even with the best of intentions, as players and team struggle over the division of sports revenue. Although the median salary of players is about \$500,000, even well-paid employees may want to strike and use other tactics to earn more, especially when their careers last only a few years. And while owners are frequently successful businesspeople who get a thrill from involvement in sports, they still want to keep down costs and earn a reasonable return on their investments.

FOR RICH OR FOR WORSE. Instead of a salary cap, baseball should tax total spending by major league teams on players, player development, and anything else that may improve a team's record. For example, they might impose a 33% tax on all spending for those purposes by a team above \$40 million, approximately the average amount spent by Major League Baseball teams in these ways. At the end of the negotiations between owners and players, the union sprang this kind of tax on the owners.

Such a tax would discourage excessive spending of the arms-race variety. In addition, since the tax revenue collected by the leagues would be distributed to all teams, it would help compensate owners in small markets for the greater resources of the New York Yankees, Los Angeles Dodgers, and other teams in large markets.

But a tax on spending is not enough, for it does not give badly run teams an added financial incentive to improve their records and make the races closer. This can be accomplished with a second tax on teams that perform below average.

The more games a team lost in the previous year or two, the larger would be the amount it would be obligated to pay into the league's treasury. Such a tax would encourage weak teams to try harder, whereas the rookie draft favor rather than punish teams that do badly. When weak teams are favored, they have less incentive to become more competitive through their own actions—such as improving the quality of their decisions and management.

The predictable result: close and efficient competition without a salary cap and without shifting the balance of power toward owners

GARY S. BECKER, THE 1992 NOBEL LAUREATE, TEACHES AT THE UNIVERSITY OF CHICAGO AND IS A FELLOW OF THE HOOVER INSTITUTION



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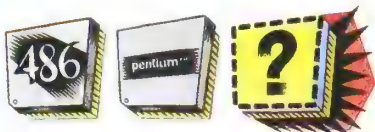
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BY GENE KORETZ

U.S. EXPORTS TO JAPAN: BOXES STUFFED WITH LOW-COST GOODS

Even as the U.S. continues to seek trade concessions from Japan, economists are underscoring the difficulties in reducing the imbalance in their trade flows. A recent analysis by Joseph P. Quinlan of Dean Witter Reynolds Inc. casts intriguing light on the problem.

Quinlan's focus is containers, the 40-foot-long metal boxes that are transported by ship from port to port and then carried by railcar or truck to their final destinations. Ironically, notes Quinlan, when measured in terms of containers, "the U.S. can boast of a consistently strong trade surplus with Japan." Last year, it sent nearly 619,000 containers to Japanese ports, 44% more than it received (chart).

In trade data, however, the devil is often in the details. U.S. containers bound for Japan, Quinlan notes, are mainly stuffed with high-volume low-val-

ue primary products, such as lumber, waste paper, scrap metal, grass seed, and resins. In fact, the lead item on the list last year had nothing to do with America's new global competitiveness: It was some 65,000 containers of hay—the stuff cows like to munch on.

By contrast, Japan's top container exports to the U.S. consist of auto parts, tires, and other components required by Japanese transplants. And the next largest category is electrical goods, including office machines, stereo equipment, and computer parts. Thus, while America's biggest exports to Japan are commodity-type low-value-added products, Japan's

exports to the U.S. are predominantly high-value-added products. To be sure, Japanese purchases of such billion-dollar, high-tech U.S. exports as aircraft, electronic components, and computers are up 25% to 30% this year, despite Japan's recessionary climate. But, as economist Rosanne M. Cahn of CS First Boston notes, America is also buying more of these products from Japan, widening the trade deficit in these items by nearly 20%.

"If imports start out much larger than exports," says Cahn, "it takes enormous growth in exports to adjust trade—particularly if major U.S. imports from Japan are still growing rapidly."

DO TAX INCENTIVES REALLY PUSH PEOPLE TO SAVE MORE?

At first glance, the array of tax incentives devised by Congress in recent decades to boost household savings has been a striking success. More than 40 million people now have 401(k) plans, for example. And the annual sums pumped into 401(k)s, individual retirement accounts (IRAs), and the like have soared from just \$5.4 billion in 1980 to \$66 billion in 1990.

The critical question, however, is whether the plans have induced taxpayers to save more. In a study in *Brookings Papers on Economic Activity*, economists Eric M. Engen, William G. Gale, and John Karl Scholz note that there's nothing to stop people from reducing their taxes by using past savings or even borrowed funds to make contributions to IRAs, 401(k)s, or other plans. They can also choose to squirrel away the same amount they would have anyhow, while spending the extra cash provided by a lower tax bill.

To find out how people actually behaved, the study looked at two matched groups of savers presumably influenced by tax incentives: 401(k) participants and IRA participants not eligible for 401(k) plans. Because the 1986 tax reform act slashed IRA deductibility while expanding opportunities to save via 401(k)s, the researchers figured that by 1991 the savings of the latter group should have grown a lot more than the IRA group. Instead, they found no real difference in asset growth from 1986 to 1991.

The economists conclude that most of the funds flowing into tax-incentive plans are not new savings but substitutes for other forms of savings. And while some may disagree, their results are bolstered by one salient fact: The personal savings

rate, which averaged 7% from 1950 to 1980, has slumped to the 4.5% range, just as contributions to savings incentive plans have taken off.

AS WAGE PRESSURES POP UP, KEEP YOUR EYES ON THE MIDWEST

While U.S. wage inflation still appears tame, several regional banks of the Federal Reserve report worker shortages for skilled construction, manufacturing, and clerical jobs in their districts. And shortages of temporary workers are cropping up in such cities as Chicago, Dayton, Denver, and Austin, Tex.—forcing some temporary help agencies to start bidding up wages.

If that trend accelerates, it will take hold first in the Midwest, predicts Mark M. Zandi of Regional Financial Associates Inc. That's because the Midwest, unlike other regions with upswings in industrial activity, continues to suffer from out-migration. Indeed, Zandi notes that jobless rates are now below 6% in Chicago and Detroit, 5% in Indianapolis and Milwaukee, and 4% in Des Moines, Minneapolis, and Omaha.

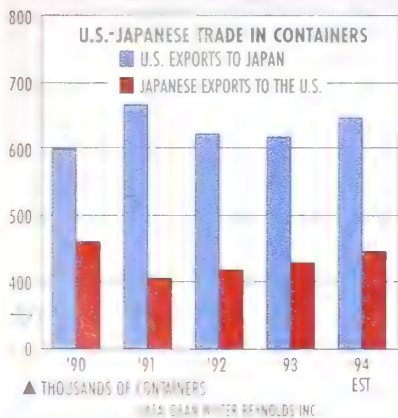
SOLVING THE RIDDLE OF BRITAIN'S HIDDEN JOB GROWTH

Though Britain's economy grew at a 4.4% rate in the second quarter, employment has been declining since mid-1993. Economist Leo Doyle of Kleinwort Benson Securities Ltd. explains the anomaly by pointing to a problem also plaguing U.S. labor statistics.

Doyle notes that while the official British Employment Dept. measure is weak, the rival Labour Force Survey shows employment gaining ground over the past year. Like the U.S. payroll and household surveys, the former counts jobs reported by employers while the latter is based on a survey of households. And as in the U.S., the employer-based survey can miss the boat when job creation by small new businesses is accelerating.

That, in fact, is exactly what Doyle thinks has happened over the past year or so. He cites a recent canvass by the British Chamber of Commerce that shows strong hiring activity among small companies with under 200 employees. If Doyle is right, recent tax and interest rate hikes are more likely to slow than to derail Britain's consumer recovery.

A SURPLUS AMERICA ISN'T CELEBRATING



ue primary products, such as lumber, waste paper, scrap metal, grass seed, and resins. In fact, the lead item on the list last year had nothing to do with America's new global competitiveness: It was some 65,000 containers of hay—the stuff cows like to munch on.

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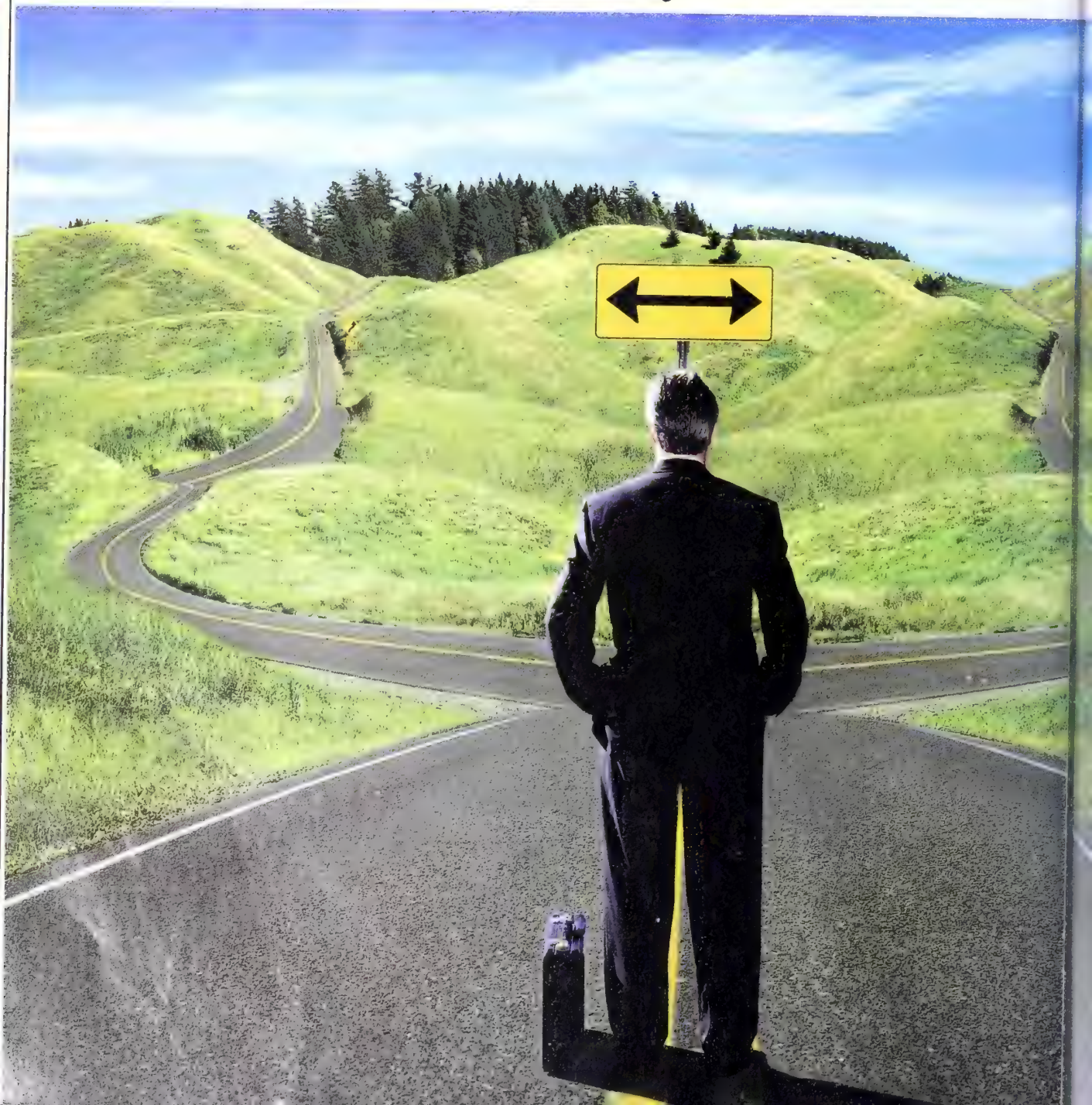
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THE FED HOLDS STEADY FOR NOW —BUT BEWARE THE IDES OF NOVEMBER

The nation's business economists, gathered in Washington for their annual confab on Sept. 25-28, had a message for the Federal Reserve: We like your interest-rate hikes this year, but now it's time to cool it. In short, the economists don't expect the Fed to listen. The National Association of Business Economists' policy survey of 158 members showed that a 67% majority felt comfortable with monetary policy prior to September. That's a ringing endorsement of the central bank's 1% percentage-point boost in short-term interest rates since July 24. However, even though 72% expect a more restrictive policy, a hefty 54% think that the Fed should refrain from further tightening.

WHAT THE BUSINESS ECONOMISTS SEE 1995

	1994	1995
GDP*	3.6%	2.6%
INFLATION*	2.7	3.3
UNEMPLOYMENT*	6.2	5.9
4TH QUARTER GROWTH**	4.90	5.28
4TH QUARTER BOND**	7.80	7.75

*AVG. **YEAR-END LEVEL
DATA: NATIONAL ASSOCIATION OF BUSINESS ECONOMISTS

up in the meantime.

Although the Fed's inaction signaled its current satisfaction with the economy's pace, it is very likely that the central bank did adopt a policy bias toward tightening on Sept. 27. That's a formal decision that notes the Fed's concern about inflation but says that immediate action is unwarranted. The agreement gives Fed Chairman Alan Greenspan the discretion to tighten at any time before the November meeting.

GREENSPAN WILL KEEP AN EYE ON THE DATA

On Oct. 13-14, when a bevy of crucial indicators for September hits the news wires, including producer and consumer prices, retail sales, and industrial production. However, with the economy apparently slowing down, the data may not justify a hike.

The economists' cautious attitude toward more rate increases is reflected in the NABE's 1995 forecast, which predicts slower growth with little rise in inflation (table). The economists believe that the third quarter will

mark an important transition from the heady pace of growth since last summer that began to fuel inflation fears. They expect real gross domestic product to grow by 3.6% in 1994 and then slow to a modest 2.6% pace in 1995. That's close to the economy's noninflationary long-term trend.

In fact, the economists think growth is already tapering off. They expect third-quarter expansion in real GDP to fall to 2.3%, from 3.8% in the second quarter. And there is a good chance that the pace could slip below 2%, which would spark fears that the Fed's inflation-fighting zeal may be harming the economy.

If so, the Fed also would be hard-pressed to justify another rate hike even at its November policy session, especially since the central bank will be meeting only three weeks after the release of the third-quarter GDP report.

The economists think the trigger for the next Fed move will be rising inflation, as measured by the consumer price index. Their forecast calls for 2.7% inflation this year and 3.3% in 1995. The NABE believes it is worth emphasizing, however, that inflation probably has bottomed out for this business cycle, and that the greater risk is that inflation will be higher than expected, rather than lower.

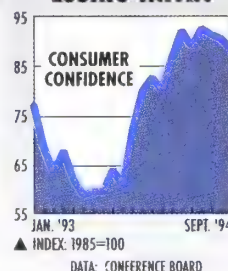
The bright spot in the inflation outlook is labor costs. The forecasters look for the unemployment rate to average 6.2% in 1994 and 5.9% in 1995, about the rate they believe to be consistent with stable inflation. And because of the moderate pace of wages and benefits, combined with productivity gains, the forecasters expect unit labor costs to grow only 1.4% in 1994, picking up to a still modest 2.5% in 1995.

SLOWER GROWTH IN MOST SECTORS

The NABE expects the slowdown in economic growth to be broad, led by the sectors most sensitive to higher interest rates. In 1995, the pace of consumer spending will cool down about in line with overall GDP. Housing will drop off sharply. Business investment will slow from its brawny 1994 pace but continue to power the expansion. And while exports will pick up, the trade deficit will remain a slight drag, because of rising imports.

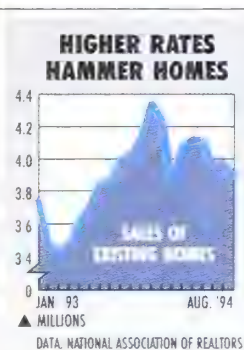
Already, consumers show signs that they are tiring—and

CONSUMERS: LOSING FAITH?



perhaps losing faith in the economy (chart). The Conference Board's index of consumer confidence declined for the third consecutive month in September, falling two points, to 88.4. Respondents were markedly less positive about prevailing conditions and slightly less optimistic about the months ahead.

Although confidence remains at a level that historically has been associated with a "reasonably lively economy," the Conference Board also said that plans to buy homes, new cars, and appliances all fell in September, with car-buying intentions down for the second consecutive month.



With higher interest rates already hitting housing demand, the NABE expects little contribution from housing next year. August sales of existing homes fell 1.8%, to an annual rate of 3.9 million (chart). Except for a weather-depressed February reading, that was the lowest level of the year and far below the recent peak hit in December of last year. For 1995, the forecast-

ers see residential investment growing a meager 1.2%, down from a 9.5% advance this year.

The National Association of Realtors says that higher mortgage rates and home prices have reduced housing affordability back to where it was two years ago. The rate rise during the past year increases the monthly payment on a 30-year, \$150,000 mortgage by about \$180, enough to shut some buyers out of the market.

RISE IN OPPOSITION TO MORE RATE HIKES The NABE predicts that the nation's manufacturing sector will post especially solid gains over the next two years, with industrial output expected to rise 5.3% this year and 3.5% in 1995. Both gains are well above those for the economy as a whole. Exports and business investment

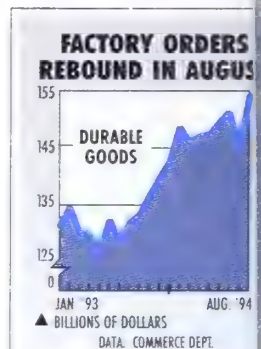
in equipment will lead the manufacturing-sector strength.

Factory orders for durable goods rebounded by 6% in August, after falling 4% in July (chart). Autos, which had accounted for more than half of the July drop, contributed more than half of the August jump. That pattern reflected the July shutdowns for retooling. The pace of orders still shows signs of cooling off, though. Bookings so far in the quarter are no higher than their second-quarter average, and unfilled orders in August fell for the second consecutive month.

Naturally, the National Association of Manufacturers would not like to see higher interest rates impede the progress any more than necessary. A NAM survey of 10 executives revealed massive opposition to any further hikes in rates. And the National Retail Federation sent a letter to Greenspan, asking the Fed to take it easy.

Still, the NABE economists look for short-term rates to rise, but not by a lot. They expect the rate on three-month Treasury bills to increase from a September average of 4.55% to 5.28% by next December, implying about three-fourths of a percentage point of Fed tightening. Long-term rates already appear to embody expectations of an even greater increase in short rates, so the forecasters expect the rate on 30-year Treasury bonds to end 1995 at 7.75%, a shade below the current level.

If the forecasters are right about economic growth and inflation, one additional half-point rate increase by the Fed in the coming year may well be all that's needed. But since Greenspan has already said that he would prefer policy to err on the side of restraint, there's a good chance the NABE, a raft of executives, as well as the Administration, will be disappointed with future monetary policy.



THE WEEK AHEAD

NAPM SURVEY

Monday, Oct. 3, 10 a.m.

The National Association of Purchasing Management's September index of industrial activity is expected to have risen to 56.5%, says the median forecast of economists surveyed by MMS International, a unit of McGraw-Hill Inc. The August index was 56.2%.

CONSTRUCTION SPENDING

Monday, Oct. 3, 10 a.m.

August construction outlays probably increased by 0.3%, according to the forecasters, following a 0.6% gain in July. Residential outlays are weakening in response to higher interest rates.

LEADING INDICATORS

Tuesday, Oct. 4, 8:30 a.m.

The composite index of 11 leading indicators likely rose 0.5% in August. The July index was flat.

VEHICLE SALES

Tuesday, Oct. 4

Sales of U.S.-made vehicles probably totaled 12.7 million units, at an annual rate—7.2 million for cars, 5.5 million for trucks. August sales were 12.9 million.

FACTORY INVENTORIES

Wednesday, Oct. 5, 10 a.m.

Manufacturers' August inventories likely rose 0.2% after July's 0.9% increase.

EMPLOYMENT

Friday, Oct. 7, 8:30 a.m.

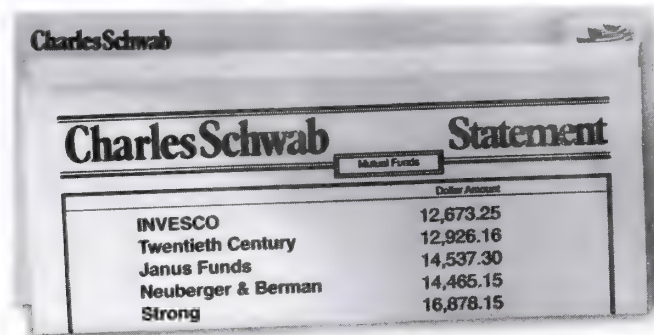
September payrolls are expected to have risen by 248,000 after August's 179,000 gain, while the forecasters look for the unemployment rate to hold steady at 6.1%. The MMS survey also foresees a 0.3% gain in hourly earnings and a 20,000 increase in manufacturing jobs.

INSTALLMENT CREDIT

Friday, Oct. 7, 4 p.m.

The volume of consumers' outstanding installment debt probably rose \$8 billion in August following a \$5.6 billion increase in July, although that's still below spring's double-digit pace.

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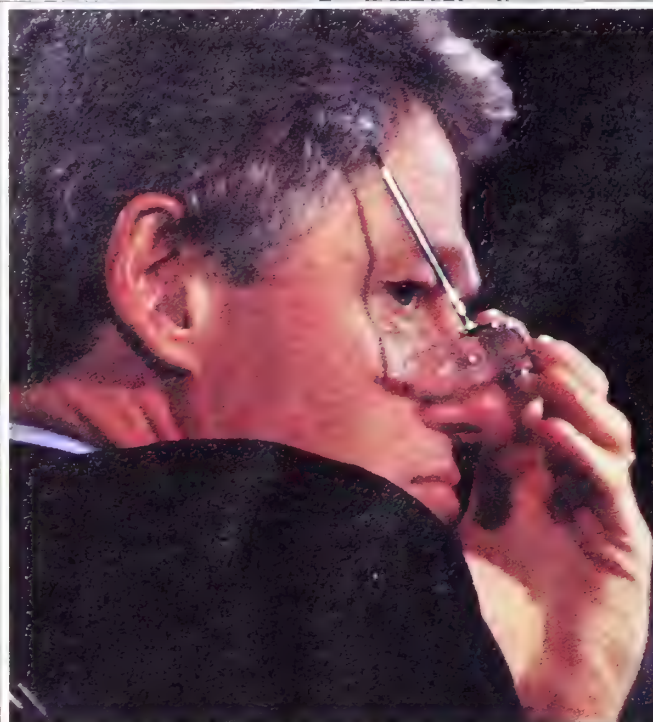
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WHY BUSINESS HATES CLINTON

LEADERSHIP AND CHARACTER ISSUES OUTWEIGH GAINS ON TRADE AND JOBS

Business Week/Harris Executive Poll

America's business leaders have very little good to say about Bill Clinton in a new BUSINESS WEEK poll. Even though the President cut the budget deficit and promoted U.S. exports, 92% give him weak marks for leadership. An overwhelming majority criticize Clinton's trade policy, his economic performance—even his economic advisers. And 82%, up from 45% after the 1992 election, view the Clinton-Gore team not as a new breed of Democrat, but as "tax and spend" liberals in disguise. Only

the Federal Reserve wins decent grades, with 48% of the executives supporting the central bank's efforts to strike a balance between reining in inflation and spurring economic growth.

Senate Minority Leader Bob Dole can't take much comfort from the findings. Clinton's main GOP antagonist ranks a weak fourth among the executives' picks for a 1996 Republican Presidential challenger, while former Defense Secretary Dick Cheney came in first.

THE BIG PICTURE

■ How do you rate President Clinton's handling of the economy—excellent, pretty good, only fair, or poor?

Excellent 1%	Only fair 57%	Don't know/ not sure 0%
Pretty good 14%	Poor 28%	

THE SPECIFICS

■ How would you rate the Clinton Administration on each of the following—excellent, pretty good, only fair, or poor?

	Excellent	Pretty good	Only fair	Poor	Not sure
Providing strong leadership	0%	8%	32%	60%	0%
Reforming the health-care system	1%	8%	18%	72%	1%
Cutting the deficit and government spending	3%	10%	40%	46%	1%
Ensuring economic growth	1%	16%	56%	26%	1%
Creating jobs	2%	20%	51%	25%	2%
Fighting crime	2%	24%	44%	30%	1%
Assuring fair trade	7%	47%	35%	10%	1%

GETTING TOUGH WITH JAPAN

■ President Clinton promised to press Japan to ease trade and investment barriers that impose unfair obstacles to American companies. How do you rate his performance to date—excellent, pretty good, only fair, or poor?

Excellent	1%
Pretty good	21%
Only fair	52%
Poor	24%
Don't know/ not sure	2%

BIG SPENDERS?

■ Which of the following statements is closest to your view of the Clinton-Gore Administration?

	9/94	11/92
They are a new breed of Democrats more attuned to economic growth and the concerns of middle-class Americans	15%	53%
They are posing as champions of growth and the middle class but are really "tax and spend" liberals in disguise	82%	45%
Not sure	3%	2%

s the 103rd Congress whimpers to a close amid the familiar sounds of crashing legislation and an bombast, a grim President Clinton licking the wounds he suffered at hands of increasingly balky lawmakers. But if Clinton has had a rough year at Capitol Hill, corporate lobbyists are very aglow over the legislation they passed—or, in the case of health reform—managed to kill.

Herein lies a key irony of the Clinton presidency: Despite his best efforts to them, Corporate America's top executives have nothing good to say about President Clinton. A BUSINESS WEEK/Harris Poll of 400 senior executives conducted from Sept. 19 to Sept. 26 finds that 85% of them disapprove of President's handling of the economy. They give the Administration especially poor marks on creating jobs, rein-in government spending, and slowing economic growth. In general, American executives simply don't have faith in the President's ability to lead.

At the heart of big business' visceral dislike for Clinton is the health-care de-

bacle. That legislative defeat left many CEOs convinced that, beneath the President's New Democratic trappings, there still lurks the heartbeat of a traditional liberal. "From time to time, like with NAFTA, Clinton does things that no Old Democrat would do," says Edgar S. Woolard Jr., chairman and CEO of DuPont Co. "For most of us, it doesn't happen frequently enough. There's still a propensity to look for a big-government solution."

Corporate America's downbeat assessment of Clinton comes after two years of impressive gains for business in Washington. Case in point: the budget. Last year, the President spurned liberal advisers' pleas for costly social spending and made deficit reduction his top goal. His plan helped drive down long-term interest rates, fueling the expansion. Says Salomon Inc. CEO Robert E. Denham: "Clinton dealt responsibly with

the budget." Not according to most of his colleagues: Some 82% of those polled said Clinton had done only a fair or a poor job of ensuring economic growth.

Clinton's record on trade expansion has been equally bold. First, he risked civil war within his own party to seal NAFTA. This year, he's fighting hard for a new General Agreement on Tariffs & Trade. And Clinton extended China's most-favored nation trade status and paved the way for U.S. investment in a booming Vietnam. The Administration's trade push, says Texas Instruments CEO Jerry R. Junkins, "will mean more exports, more jobs, and a stronger economy."

For his efforts, Clinton gets some grudging credit from Corporate America. Slightly more than half of those polled thought he had done well at achieving fair trade—though his marks on dealing with Japan are decid-

Much of business' antagonism stems from Clinton's health plan, which execs saw as an expensive government intrusion

HEALTH CARE'S PULSE

President Clinton's campaign to provide guaranteed, universal health coverage for all Americans has run into trouble on Capitol Hill. Do you agree or disagree that:

	Agree	Disagree	Not sure
Clinton's proposal gave government too much of a role in running health care	94%	5%	1%
It's better to put off health reform for this year	89%	10%	1%
Despite flaws in the current plans, health reform is a good idea and needs to be pushed	69%	28%	3%
The market is already cutting costs and improving quality so well that federal reform isn't needed	56%	39%	5%
Lobbyists and special interests killed worthwhile reform	28%	69%	3%

OPTIMISTIC VOICES

Overall, how would you characterize your outlook for the U.S. economy in the next 12 months—would you say you are very optimistic, somewhat optimistic, somewhat pessimistic, or very pessimistic?			
Very optimistic	4%	Somewhat optimistic	77%
Somewhat pessimistic	19%	Very pessimistic	0%
Not sure	0%		

RATING THE ECONOMISTS

How do you rate President Clinton's team of economic advisers—Treasury Secretary Lloyd Bentsen, National Economic Council Director Robert Rubin, Council of Economic Advisers Chair Laura Tyson, Commerce Secretary Ron Brown, Labor Secretary Robert Reich, Budget Director Alice Rivlin—excellent, pretty good, only fair, or poor?			
Excellent	2%	Only fair	52%
Pretty good	20%	Poor	26%
Not sure	0%		

DEALING AT THE FED

President Clinton has named two new members to the Federal Reserve Board. Both appointees believe that the Fed should do

more to spur economic growth and should not be overly restrictive when it comes to fighting inflation. Given the state of the economy, which one of the following statements do you most agree with?

Inflation is a real threat and the Fed is wise to have moved early and aggressively to raise interest rates	14%
Inflation is not that much of a threat and the Fed should be more concerned about keeping the economic expansion going	38%
The Fed has got the balance about right	48%
Not sure	0%

A ONE-TERMER?

■ If you had to make a choice today, would you support President Clinton for reelection, or not?			
Yes	9%	No	87%
Not sure	4%		

BOB AND COLIN AND DICK AND ROSS

■ Which one of the following would you vote for if the election were held today?	
Former Defense Secretary Dick Cheney	27%
Former Chairman, Joint Chiefs of Staff Colin Powell	19%
Former Housing & Urban Development Secretary Jack Kemp	19%
Senate Minority Leader Bob Dole	13%
Texas Senator Phil Gramm	7%
Former Tennessee Governor Lamar Alexander	3%
California Governor Pete Wilson	2%
Former Vice-President Dan Quayle	2%
Independent Ross Perot	0%
None of these	5%
Not sure	3%

Edited by Michele Galen & Mark N. Vamos

Survey of 400 senior executives drawn from the BUSINESS WEEK 1000. Interviews were conducted Sept. 19-26, 1994 for BUSINESS WEEK by Louis Harris & Associates Inc.

edly lower. Clinton's trade efforts haven't won him much support from partisan legislators, though. By embracing GATT and NAFTA, the President essentially adopted Republican policies. Yet earlier this year, Hill Republicans threatened to sink GATT unless the White House made key concessions. GOP obstructionism became so intense that a delegation of Business Roundtable leaders had to urge Senate Minority Leader Bob Dole (R-Kan.) to knock off the

as hard as anybody has ever worked on selling American business," says John F. Welch Jr., chairman and CEO of General Electric Co. Boeing CEO Frank A. Shrontz agrees. The Clintonites are much more willing to advance U.S. commercial interests abroad, he says: "They're not free-market ideologues."

Corporate America did fine riding in tandem with Clinton. But it did equally well when they diverged. Take the Administration's drive for a new national

tive agenda, from hiking the minimum wage to beefing up the Occupational Safety & Health Administration, we nowhere on the Hill.

Business would have fared even better had some of its pet issues not gotten caught in a partisan crossfire. Ge scorched-earth tactics could sink business-backed legislation to revamp the Superfund toxic-waste cleanup program. "There's no ideological reason to hold this up," says the American Insurance Assn.'s Michael McGavick. "The only gain is popping Clinton in the no again."

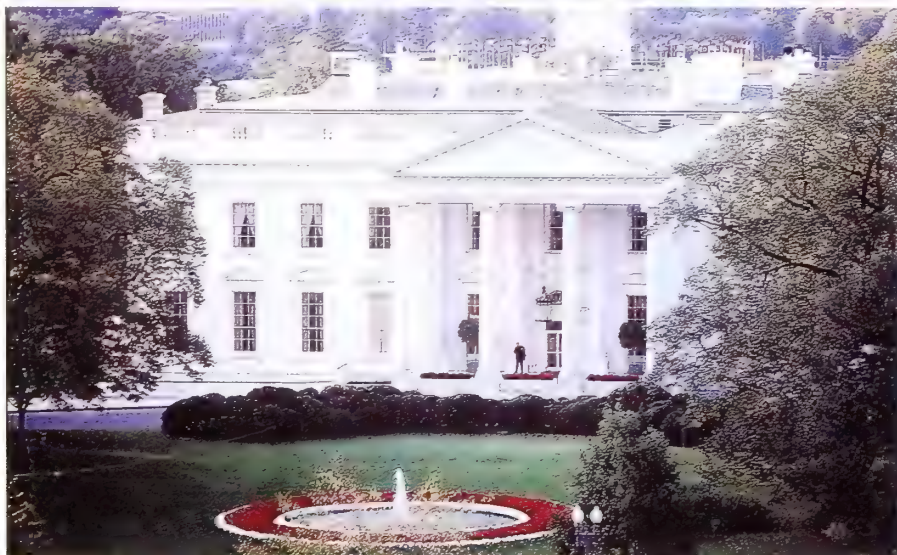
CHANGES AHEAD. These injuries from friendly fire aside, Corporate America has won the best of both worlds by shrewdly playing on divisions within Hill Democrats. On trade issues, business teamed up with Clinton and his party's free-trade minority to defeat protectionists. Then, on health reform, a bloc of Democratic centrists joined forces with Republicans to defeat the Administration. Business lobbyists came to realize that in today's Congress, the balance of power is held by younger, pro-business Democrats. "These newly elected Democrats don't have 30 years of New Deal and Great Society in them," says Senator Bob Packwood (R-Ore.). "They are more familiar with business and more concerned about regulation."

The influence of probusiness centrism will grow next year, since the midterm elections in November should produce a far more conservative Congress. "If the President wants to make real policy changes, he'll have to move to the center," predicts Representative Michael Andrews (D-Tex.).

Such a shift could improve odds for legislation that would grant companies greater power to challenge government regulations, ease the burden of product-liability suits, and put in place modest health-insurance reforms. Never one to stick to a hopeless position, the President may well embrace some of these initiatives.

Even so, he's unlikely to get much credit. House Ways & Means Committee Chairman Sam M. Gibbons (D-Fla.) chalks up the antipathy more to business' "upper-income attachment to the Republican party than anything else." But it still gets under the President's skin. On Sept. 25, he told a New York audience that "the American people, with this sort of partisan, negative pounding... do not know what we've done." When it comes to the sentiment in America's boardrooms, he may have a point.

By Richard S. Dunham with Douglas Harbrecht and Judith H. Dobrzynski in Washington, and bureau reports



WASHINGTON'S BUSINESS AGENDA

TRADE Clinton's support helped win congressional passage for NAFTA, and likely passage for GATT in the face of spirited opposition.

EXPORT PROMOTION Among other efforts, Commerce Secretary Ron Brown announced \$6 billion in export deals during his recent China mission, and helped seal a \$4 billion deal for AT&T in Saudi Arabia.

BANKING Though banks are under Administration pressure to step up lending to minorities, financial institutions hit a home run with passage of the interstate banking bill. And Clinton's community development banking initiative gave the industry relief from federal red tape.

TELECOMMUNICATIONS A bipartisan compromise designed to overhaul telecom regulations died after eleventh-hour lobbying from regional phone companies, who said it was tilted toward long-distance competitors.

HEALTH Health reform was buried under an avalanche of business complaints that it was too bureaucratic and too expensive.

games and support the pact. He did.

Clinton's belief in industrial policy—nurtured during his days as Arkansas' governor—turned him into American business' top salesman. Commerce Secretary Ronald H. Brown has become a roving pitchman for U.S. exports, and the Administration nailed down lucrative foreign contracts for U.S. multinationals hawking airliners, telecommunications gear, oil-drilling equipment, and auto parts. Brown & Co. are "working

health system, to be partly funded by mandates on employers. Although CEOs of old-line manufacturing industries initially backed reform, strong business opposition to the plan's rigid bureaucratic structure helped defeat the President's top domestic initiative.

Despite Clinton's endorsement, business easily turned back an AFL-CIO bill that would have barred the hiring of permanent replacements for striking workers. Indeed, most of labor's legisla-

ALL THE PRESIDENT'S ZOMBIES

ck of appointees, drained of their power, are still hanging around

You see them wandering stiffly all over Washington—political lost souls staggering through the mps of their own misfortune. re known as “zombies” in capital nce, and Bill Clinton has done more well their ranks than Dr. John the t Tripper, the celebrated voodoo er.

ho are these unfortunates? They're washouts and would-have-beens of Clinton Administration—folks such as Warren M. Christopher. This g, the White House leaked l that the President dn't mind if his Secretary ate quit next year. Ever e, Christopher's authority ebbed; lately, he has seen diplomatic missions subcon- ed out to former President y Carter.

RED PAIN. Christopher has of company in limbo, ks to his boss's aversion ing underperforming aides. Presidents, even such nense types as Richard M. n, have had trouble cut- loose associates. But Bill are your pain” Clinton has d this Presidential dither- o an art form. “There's a istent pattern,” sighs a on adviser. “He pouts, but sn't tough enough to fire le. So they end up as ing zombies.”

emocratic National Commit- Chairman David C. Wilhelm d the ranks of the undead summer, when Clinton ed former California Representative y Coelho to be a “senior adviser” to ONC. In effect, the move put Coelho, investment banker with Wertheim oeder & Co., in charge of midterm ion strategy. That left Wilhelm with acious office, a swell view of the hington skyline—and no operational ority. He will stay on through the ion cycle and then is expected to re- to Chicago Democratic politics.

White House Political Director Joan aggett met a similar fate. The for- labor lobbyist got poor marks from te House pols and was expected to er job as part of Chief of Staff n E. Panetta's recent White House

reorganization. She now plans to depart at the end of the year. For months, key political decisions have been made by a team that includes Deputy Chief of Staff Harold C. Ickes and Panetta lieutenant Doug Sosnik.

Press Secretary Dee Dee Myers has scarcely fared better. Convinced that the 33-year-old former campaign aide lacked the stature and media savvy for the job, Panetta has been trying to force Myers into a subsidiary role since the

over in Foggy Bottom, spinmeister David R. Gergen—banished from the White House when the Clintons tired of his conservative advice—is happy working on ways to turn the U.S. occupation of Haiti into a public-relations bonanza. “Clinton constantly creates these disempowered nobles,” says Jeffrey A. Sonnenfeld, an Emory University management professor. “They have fiefs, but no legitimacy.”

ROOTLESS SOULS. The President's belief in redemption is legendary and, judging by his own career, warranted. But he has created a chorus of rootless souls, and he may well pay a future price for his lax personnel policies. “In the short run, Clinton thinks he's being a good boss by helping staffers extend their jobs,” says James P. Pfiffner, a George Mason University political scientist. “But in the long run, Presidents have got to



OUT
President Clinton's compassion—or indecision—has limits. Defense Secretary and managerial bust Les Aspin was ousted last year



IN
White House press aide Dee Dee Myers got a raise and a new, larger office—but she's still expected to be out by the end of the year



GOING?
Secretary of State Warren Christopher is in limbo, his authority ebbing as freelancers such as Jimmy Carter invade his turf

summer. When she balked, Clinton agreed to a typically Byzantine deal: Myers will be promoted to Presidential assistant, with a raise and larger quarters. She has told associates that she plans to exit by yearend; in the meantime, she's in.

Some Clintonites never seem to decamp, no matter what their travails. White House Communications Director Mark D. Gearan, recently shifted to his third assignment as head of a nonexistent long-range planning unit, seems content with his ghostly travels through the West Wing. Former Chief of Staff Thomas F. “Mack” McLarty III finds his nonjob of business liaison satisfying. And

be ruthless in making tough decisions.”

Of course, even Clinton's compassion has its limits. He engineered last year's ouster of Defense Secretary Les Aspin, a managerial bust, and bid adieu to Arkansas chum Webster L. Hubbell when legal woes made Hubbell's position as Associate Attorney General untenable. But by and large, Clinton still is unwilling to confront wayward staffers and say: “Your time is up.” That stern dictum seems to have had the desired effect on the Haitian junta. What a growing number of Clinton-watchers are wondering is: Why doesn't the President apply it a little closer to home?

By Lee Walczak in Washington



STRIKE AT FLINT: "TRYING TO BUILD TOO MUCH PRODUCT WITH TOO FEW PEOPLE"?

RUMBLE IN BUICK CITY

Is GM running too lean—or not lean enough?

Linda Cromwell is bone-tired. The 40-year-old welder at General Motors Corp.'s giant Buick City complex in Flint, Mich., has been working six days a week and up to 12 hours a day, trying to keep up with demands for transmission parts. "I work from 6 to 6, rush dinner, and then try to help my sons with their homework," sighs the mother of three. "It's a lot of stress."

GM has loads of weary workers these days. Surging demand for its cars and trucks has collided with the company's steady downsizing to improve its productivity. The inevitable result: more work with far fewer workers to do it. On Sept. 27 the situation reached the breaking point, as far as workers are concerned. Cromwell and 11,500 of her fellow United Auto Workers at the Buick City complex walked off the job, declaring: no more. Workers at two other GM

transmission plants are threatening similar walkouts.

If it lasts, the Buick City strike will quickly paralyze GM. Already, it has halted car assembly there and idled 5,550 workers at two plants in Lansing, Mich. But more important, it stopped Buick City's production of engines and components for transmissions and suspensions, which could cripple GM in days. One key part, a torque converter, goes into 85% of GM's automatic transmissions. Without it, 28 of GM's 29 North American assembly plants could shut down within a week, analysts say.

TEMP TABOO. Given such numbers, many observers think GM may have to back down soon. A short walkout likely wouldn't prevent its North American operations from ending the year in the black. But net losses could reach about \$150 million a day during a shutdown,

analysts estimate, and that would add up fast. The timing also couldn't be worse for GM. It was just rebuilding inventories after brisk sales and lengthy production changeovers for new models cut into supplies. Such key new models as the Chevrolet Lumina and the Oldsmobile Aurora are already in short supply.

Beyond such immediate problems, the Buick City dispute highlights GM's labor quandary. The company could hire workers to meet the breakneck pace of orders and ease worker burnout. But when efficiency measures kick in a few years from now, GM probably won't need the new personnel—particularly when the next industry slump hits. And the union objects to hiring temps to fill in.

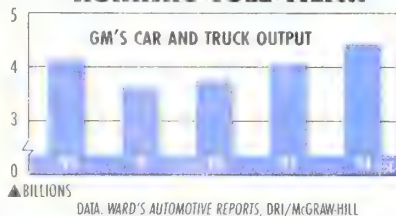
The result is a standoff. GM hasn't hired hourly workers since 1986, and senior managers, egged on by Walter Reuther, are adamant about not doing so now. "We have no intention of going back to the way things used to be," GM's Richard Wagoner Jr., GM's president of North American auto operations, said in a recent speech. "That was a going-out-of-business strategy." GM still has 4,200 laid-off workers on its payroll. However, even relocation incentives up to \$60,000 haven't lured them into moving to plants that need help.

The union argues that workers are being pushed beyond all reasonable limits. "GM is now breaking the contract by trying to build too much product with too few people," says Stephen Yonick, head of the UAW's GM Dept. "That's wrong and it's dumb. Efficiency and overwork are not the same thing."

Working heavy overtime has many rank-and-filers riled up. "I ache every night when I go home," says assembly worker Elbert Rush. Buick City workers say they have to run to keep up with cars on the line. "We've surpassed every standard management has set, and it's not enough for them," says Katrina Bauer, an electrician at the complex.

Short tempers also may be taking a toll. At a GM engine plant in Livonia, Mich., an unknown saboteur—nicknamed "Edward Scissorhands" by factory workers—cut power to the plant, briefly stop-

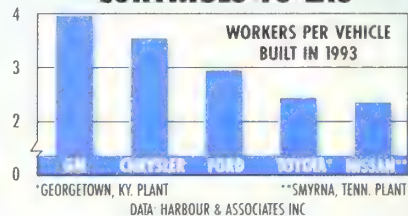
WITH ITS PLANTS RUNNING FULL-TILT...



...GM IS STILL CUTTING JOBS...



...BUT PRODUCTIVITY CONTINUES TO LAG



production on Sept. 19. And Buick has had two arson fires in recent years, although it's not clear that over-protests were the motive. Hiring temporary workers would ease pressure. GM employed some 7,000 workers during summer vacation season, many were let go after Labor Day. The union wants permanent hires to replace them and to offset retirements, an average 70 a month at Buick City alone. Now, while GM is making money, the time to insist, the union figures. David Yettaw, president of the Buick City local: "They should make cuts, but not like weasels romping in the old of gold."

ON TRIMMIN'. Other carmakers are caught in a crunch. For instance, workers at Ford Motor Co.'s Indianapolis steering-gear plant have declined overtime, forcing Ford to cut production. But neither Ford nor Chrysler is boxed in the way GM is. They shrank years ago and can now afford to add new workers—albeit sparingly—to boost production of hot products. Then, retirements will pare any excess from blue-collar rolls by the time the next recession hits, analysts say. Chrysler, for example, is adding a third shift at its Jefferson North plant in Detroit to build more Jeep Grand Cherokees, which are in short supply. The average age of workers on the first two shifts: over 50.

GM's top brass has vowed to keep trimming its workforce to match rivals' productivity by 1996. It takes Buick City workers to build a car, compared with 1.5 for Ford to build a Taurus, according to James Harbour, a manufacturing consultant in Troy, Mich. To reach such levels, GM needs only about 200,000 workers, analysts say—some 47,000 fewer than today. With nearly 15,000 workers being laid off annually, GM will be closing in on that goal within a few years.

The company has been improving assembly-line efficiency, often with the help of workers. But the big gains come from factories change over to new, easier-to-build models. For instance, GM redesigned the new Chevrolet Blazer with fewer parts and in just two-thirds the time the previous model required. Which side will blink first? To restore peace and ease the crunch, GM may be willing to agree to hire several thousand workers. And to avoid hiring even more, it may also have to ease its production pace and forgo some sales while the economy is the strongest. Neither solution is likely to please shareholders. But in the surly mood the long hours have rendered in its labor force, trying to cut down the UAW might prove costlier. *By Kathleen Kerwin in Detroit, with David Dahlstrom in Flint, Mich.*



FLYING LIGHTER: AMERICAN HAS LAID OFF 900 MANAGERS BUT BOOSTED PRODUCTIVITY

WHY DOWNSIZING LOOKS DIFFERENT THESE DAYS

For decades, the logic seemed unshakable. In good times, companies hired. In bad times, they fired. But that orderly logic has given way to a more chaotic reality: Two of every three U.S. companies now laying off employees are simultaneously hiring people.

Odd? Not according to an American Management Assn.'s study on downsizing, released on Sept. 27. Rather than lopping off heads to cut costs, managers increasingly are shrinking their companies for strategic reasons. "They're getting rid of everything that fails to give them competitive advantage, and they're [expanding] areas that add value," says Eric Rolfe Greenberg, the AMA's director of management studies.

The upshot: Nearly one in four companies reporting job cuts in the year ending June 30 had no net change in total headcounts. And the workforce actually rose at 13% of the downsizers, says the study of 713 U.S. corporations. That's one reason net job losses fell to 5.2%, from 8.4% the year before.

But if Greenberg's analysis is right, U.S. corporations are finally beginning to position themselves for future growth. American Airlines, for instance, has cut its workforce by nearly 5,000 since late 1992, but its information services unit has added about 2,200 in the same period.

Other companies also are shifting hiring from one unit to another to

keep up with changes in their business. AT&T, for example, is aggressively hiring abroad. Ten years ago, it had only five dozen employees outside the U.S.; today, it boasts 54,000, including 20,000 managers. Yet, it has shed more than 72,000 employees since 1984, mainly in the U.S. "We've been essentially hiring people with computer science backgrounds and people who can help us enter new markets here and abroad," says an AT&T spokesman.

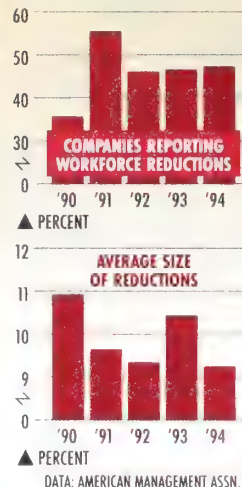
The AMA survey, indeed, indicates that restructuring often has little to do with economic conditions. Fewer than half of the downsizing companies attributed cutbacks to business downturns, vs. 65.7% a year earlier. Instead, more companies cited such reasons as "improved staff utilization" and the "transfer of production or work." Translation: Companies are learning to do more with less by reorganizing work more efficiently. American Airlines

has cut management personnel by 900 since late 1992—and boosted management productivity by 26%.

That's a major reason why, for the first time in the AMA survey, a majority of downsizing companies also are boosting profits. Some 50.6% of the companies that laid off employees from 1989 to 1994 had increases in operating income. The old saw has changed: Now, in good times, companies will fire. In bad times, they'll fire even more.

By John A. Byrne in New York

CONTINUOUS CUTTING



Commentary/by Judith H. Dobrzynski

CALL FOR PHILIP MORRIS: DON'T STONEWALL THE SHAREHOLDERS

Ask participants what happened at a Sept. 21 meeting between management and shareholders at the New York headquarters of Philip Morris Cos., and you'll hear Corporate America's version of "He said, she said." After months of trying to see management and directors, several big shareholders stormed out before discussion began on such issues as why, with tobacco woes dragging down the stock, aren't the company's huge and healthy food operations being spun off?

The disgruntled shareholders, mainly public pension funds, wanted to see outside directors—their representatives—in a cross-table, give-and-take session. Instead, Philip Morris offered presentations by Chairman William Murray, Chief Executive Officer Geoffrey C. Bible, and General Counsel Murray H. Bring, followed by a question-and-answer session with the executives and three "outside directors." But with former Chairman Hamish Maxwell and longtime PM outside counsel Robert E. R. Huntley among the outsiders, only Richard D. Parsons, CEO of Dime Savings Bank of New York, was truly independent. And Murray told shareholders that after 45 minutes the talks would continue over cocktails—hardly the setting for a serious strategy session.

No wonder bickering ensued. "The fact is, they did not have the people there we asked for," charges Sarah Teslik, executive director of the Council of Institutional Investors.

PRECIOUS TIME. "We've had 30 meetings with various investor groups and the media since Murray and Bible took over [last June]—they're very forthcoming," replies Craig L. Fuller, Philip Morris' senior vice-president for corporate affairs. "I reject the notion that [these shareholders] should dictate the precise form of the meetings."

"They're treating us as analysts, not as shareholders," complains Jon Lukomnik, who as New York City's deputy comptroller oversees its \$51 billion in pension funds. Lukomnik and others say Philip Morris stage-managed the

event, taking up precious time with presentations and handpicking a few tame nonexecutive directors.

"It's not our position that all directors should be at these meetings," Fuller counters. "All directors were aware of the meeting, but the company chose to invite these three. It's up to management to address the issues."

Both sides look silly. Lost in the folderol, though, is a key fact: Shareholders in the \$61 billion company have a legitimate gripe—and it's a big one. They aren't getting their money's worth in the market, thanks to Philip

right to hear directly why Philip Morris persists in squandering earnings.

Now they have another cause for complaint: They have no assurance that directors are questioning that strategy. From the outside, at least, the board, which includes Citicorp CEO John S. Reed, media mogul Rupert Murdoch, and transportation magnate Roger S. Penske, looks complacent. "I'm not convinced the company should be split, having listened to them," says Richard H. Koppes, general counsel of the \$80 billion California Public Employees' Retirement System, who didn't quit the Sept. 21 meeting. "But we still don't know how the independent directors on this board operate."

GONE ARE THE DAYS. Such stonewalling is inexcusable. The days when companies could insulate themselves from shareholders, communicating through Wall Street analysts, are long gone. Large institutional shareholders have a right to seek a dialogue with managers and directors, as they have at such companies as IBM, Westinghouse, and Zenith Electronics.

Sadly, in the days following the aborted meeting, neither side seemed willing to break the impasse. Some shareholders talked of running a slate of new directors at the company's annual meeting next spring and hiring a proxy solicitor to rouse votes. Teslik says she has already gotten one call from a big money manager offering support. Fuller says that "the complaint that we won't address their concerns is an empty complaint." As for the trend toward corporate openness that would suggest letting the Reeds and Murdochs on PM's board meet with shareholders, Fuller merely says, "It's something we'll continue to watch."

The PM contretemps has escalated needlessly. With both shareholders and managers digging in their heels, there's just one way out: Some of the outside directors should offer to meet with the dissidents. They may, at the moment, look hotheaded, but they're shareholders. As providers of capital, they're what makes the U.S. system work.

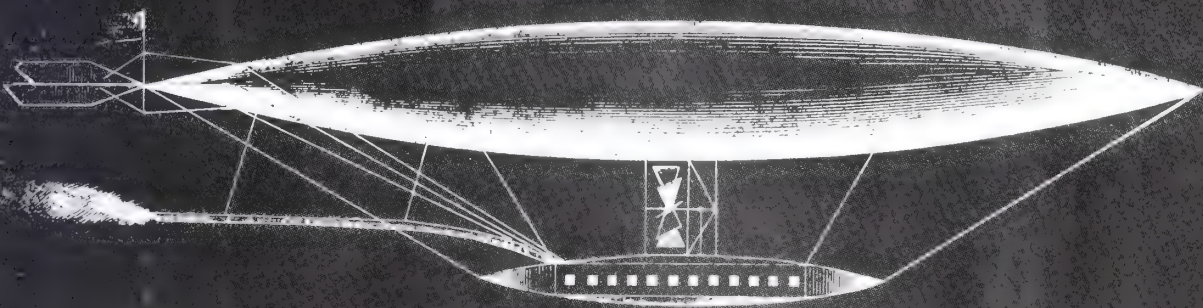
Dobrzynski writes on board issues.



Morris' strategy of redeploying the huge profits generated by tobacco to buy food properties. Over the past decade, PM has spent nearly \$25 billion buying General Foods Cos., Kraft Cos., and other food companies. On average, it paid nearly 27 times earnings.

Philip Morris' own stock, meanwhile, is trading at 10 times estimated 1994 earnings, while food companies are selling for 16 times earnings on average. Even if the company should not, for legal reasons, be split into two—as management argues—shareholders have a

Shareholders wanted real give-and-take. Instead, they got speechifying from top brass and a hurried Q&A



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BRUCE WASSERSTEIN'S REPUTATION IN M&A MADE RAISING MONEY A SNAP

AT WASSERSTEIN, LBO STANDS FOR LUMBERING BUYOUT OPERATION

A flap over Maybelline shares is only the latest in a series of missteps

Moments after Maybelline Inc. announced on Sept. 21 that its earnings would fall short of expectations, phones started to ring at the New York headquarters of Wasserstein Perella & Co. Angry investors in a Wasserstein leveraged buyout fund that had controlled Maybelline were calling to complain. Their beef: A few days before the announcement, when Maybelline had been trading at nearly \$30, Wasserstein distributed the fund's Maybelline shares to its investors—taking for itself a big chunk of the investment's gain. But as they watched Maybelline stock plummet to \$18, the investors cried foul.

Less than 24 hours later, Wasserstein agreed to recalculate the basis on which its management share was doled out, in effect handing an estimated \$10 million back to its investors. That has mollified some of the big institutions in the fund. But it hasn't ended the contretemps. Many investors complain that Wasserstein botched the entire process by dumping more than 10 million shares of a thinly traded stock on them all at once. Doing so just before Maybelline cut its earnings forecast, says one investor, "was either stupid or devious. I don't have enough facts to judge, but I'm not fully satisfied with the process."

Michael J. Biondi, a Wasserstein managing director, denies any ill intent: "I

like to think we were unlucky. We believe we have done everything we can to treat our investors fairly." But the Maybelline episode is another black eye for Wasserstein's ill-starred buyout fund, which has produced meager returns for a blue-chip list of investors who ponied up \$1.05 billion in the late 1980s (table). Though Wasserstein says the fund's annual return is in the low teens, many investors say it will be lucky to reap annual returns of 5% to 10%—far below the 25% to 50% annual gains notched up by many buyout firms. Some investors are more pessimistic: "Limited partners will be lucky to get their money back," fumes a manager at one investor. Insiders say there is the threat of imminent legal action over the accounting of profits, a rarity for a private fund.

That's a long way from the heady days of 1988 and 1989, when Wasserstein raised the buyout fund. Then the hottest name in merger-and-acquisitions investment banking, Bruce J. Wasserstein's firm had no trouble convincing investors that its M&A expertise would enable it to snap up the best deals.

It didn't work out that way. The fund started deep in a hole in 1989 with a \$350 million investment in Isosceles PLC, a British supermarket chain that turned sour within a year. And with the collapse of the high-yield bond market,

BIG BUCKS

SOME INVESTORS IN
WASSERSTEIN PERELLA BUYOUT PARTNERSHIPS
Commitment, millions

DAIWA BANK	\$100
MH EQUITY (CHEMICAL BANKING)	100
FISHER BROTHERS FINANCIAL	50
REVERE EQUITY	50
SUMITOMO BANK	25
GEORGIA-PACIFIC	25
BANKERS TRUST	25
BANKAMERICA	25
TORONTO-DOMINION INVESTMENTS	25
EMERSON ELECTRIC	15
DARTMOUTH COLLEGE	5

DATA: 1989 PARTNERSHIP DOCUMENTS

deals became scarce by late 1990. Former Wasserstein employees say that the firm compounded the problem by treating the buyout fund like a stepchild. Only a few staffers were assigned to run the fund; investment bankers were supposed to help out part-time, but the awkward arrangement didn't work well.

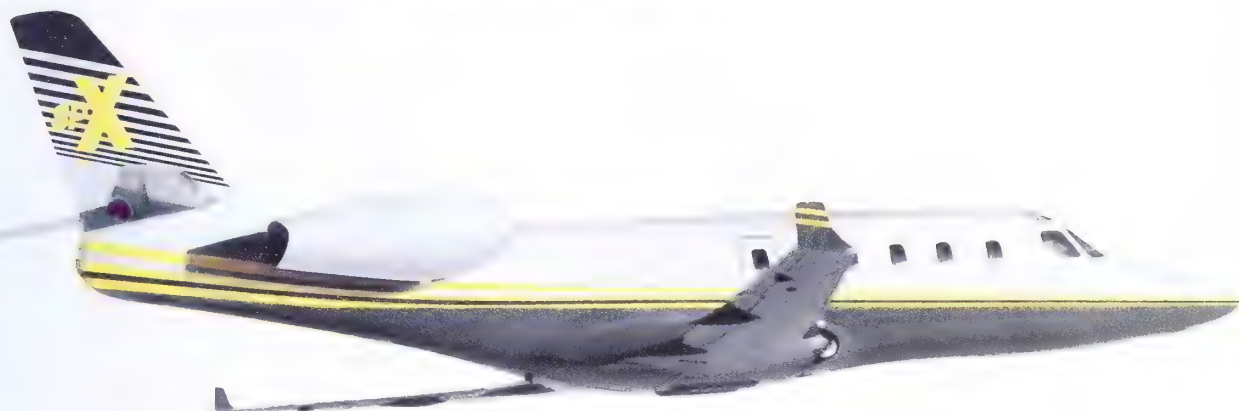
What's more, sources close to the fund say the number of potential deals was small because investment banking firms wouldn't bring their best ideas to Wasserstein, seen as a rival. Moreover, they say, Wasserstein lacked the capital during one period to contribute to the investments as required by the partnership. That may be why the fund didn't do a single new transaction during its 3½-year stretch. Randall J. Weisenburger, who now runs the Wasserstein fund, says the firm had plenty of capital and adds that the firm has had no problem finding deals.

SELECTIVE BUYING. By the time its investment period ended in August, the Wasserstein fund had put about \$90 million into only seven deals. The record: Two were disasters, a third still struggling, and the rest are winners. Meanwhile, Wasserstein was getting about \$12 million a year in management fees. And it reaped hefty fees acting as an investment banker to the fund. Selling bits of Wickes Cos. (now Collins & Aikman Group Inc.) netted at least \$30 million in fees for Wasserstein.

Of the seven deals, Maybelline was by far the biggest success. By the time the cosmetics company went public in late 1992, the Wasserstein fund had already recouped a sizable chunk of its \$155 million investment. But in recent months, says Weisenburger, some of the

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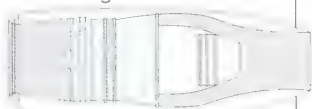


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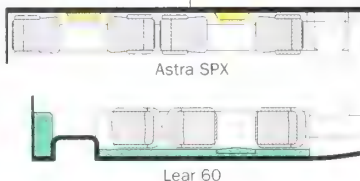
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TFE 731-40

climbing 85%, probability wind 4 Paks
SA conditions NBAA IFR reserves

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fund's investors have wanted to increase their liquidity. Maybelline seemed the obvious choice, and Wasserstein decided to distribute the stock to investors rather than sell it in a secondary offering.

Bad timing. Maybelline had been counting on growth in its new Revitalizing line of cosmetics. But late this summer, sales started to slow. Weisenburger says his firm didn't know about the slowdown until its executives were briefed by management on Sept. 20, two business days after the shares had been distributed. Most observers agree that the sequence of events was embarrassing but don't believe Wasserstein intentionally tried to cheat investors. "The timing sure looks bad, but they're just not that stupid," says a manager at a big investor not involved in the situation. And Wasserstein's Biondi insists that the firm realized it had made a mistake and moved to fix it even before investors began complaining.

CREDIBILITY GAP. But some Wasserstein investors aren't sure that's the full story. With four seats on the board and control of the company, they figure Wasserstein was keeping close tabs on operations. Also, Smith Barney Shearson Inc. analyst Holly B. Becker had sniffed trouble. Relying on information from retailers and competitors, she realized that Revitalizing was slowing and downgraded Maybelline stock on Sept. 19, the day before Wasserstein says management gave it the bad news. (Becker won't comment.) "How could an analyst on the outside figure this out, but somehow Maybelline's management didn't know?" asks an executive at one fund investor. "It strains credibility."

One reason Wasserstein may have moved with such alacrity to assuage its investors: Investment bankers say the firm is trying to launch another buyout fund. Wasserstein has put out feelers to several firms that raise money for such funds, but so far it has no takers. "Based on their record, it would be very difficult for them to raise a fund in the large institutional market," says a banker at one such money-raising firm. One of Wasserstein's angry investors puts it more bluntly: "The idea that they're starting another fund is preposterous. It belongs in a Woody Allen movie."

With deal mania back in fashion, Wasserstein bankers are having a banner year anyway. They've advised on some of the biggest transactions this year, including Sandoz Ltd.'s purchase of Gerber Products Co. They may be learning, as critics point out, that there's a big difference between advising on deals and actually doing them.

By Mark Maremont

ENERGY

STEAMED ABOUT NATURAL GAS

Producers didn't expect the weather and nuclear power to depress prices



STORAGE TANKS WERE REFILLED EARLIER THAN LAST YEAR—FURTHER CRIMPING PRICES

With natural-gas prices at their lowest level since mid-1992, it's not surprising to hear U.S. producers growling and groaning. Some are even curtailing production as they wait for better times. But executives in this business are accustomed to sudden reversals. "For 10 years running, you get encouraged, and then, for one reason or another, there's more gas than there is demand," gripes MESA Inc. Chairman T. Boone Pickens Jr.

Panic time? Not yet. Most analysts and producers expect the oversupply of natural gas—which is due in part to moderate summer weather—to prove fleeting. With demand rising, no one sees a return of the dreaded "gas bubble," or overhang of supply, that crushed prices until two years ago. "One of the reasons prices have moved so quickly is that we are very close to some sort of equilibrium in demand and supply," contends Gregory A. Dodd, vice-president for gas marketing at

Mitchell Energy & Development Cor.

Still, near-term prospects are grim. After two years of rebounding gas prices, producers and investors were hoping for another gain in 1994. Now, with spot gas prices at \$1.40 or less per thousand cubic feet, they're hunkering down for lower earnings. Analyst David C. Brashaw of PaineWebber Inc. expects gas prices to average about \$1.85 to \$1.90 this year, vs. \$2 last year, the industry's best showing since 1985. Lower natural-gas prices should drag down third-quarter earnings for independent producers by 7% on average, he figures.

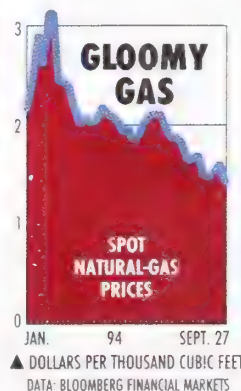
Why are gas prices in such a steep slide? A relatively mild summer—along with less need for air conditioning—depressed use by electric utilities. At the same time, several nuclear plants that were down last summer were operating this year, absorbing as much as 1.5% of the nation's gas demand. That may not seem like much. But, notes NatWest Securities Corp. analyst Christopher O. Eade, "this is a very tight market. Any changes on the margin have a very profound effect."

CANADIAN PIPELINE. Other factors, too, are forcing gas prices down: With plenty of cheap supplies around, storage operators rebuilt inventories early. The American Gas Assn. figures storage facilities are now about 90% full, two weeks ahead of last year's rate. Plus, Canada's weak dollar and a large pipeline expansion into California helped boost Canada's gas exports to the U.S. by about 12% through June, says Eade.

Producers are hoping for unseasonably cold weather. "If you get a mild winter, hang on to your hat," warns Pickens. Raymond Plank, chief executive of independent producer Apache Corp., says that if the weather stays warm and gas prices fail to rise above \$2.10 by November and December, the company could cut its drilling budget for 1995. It will spend \$265 million on drilling this year, and, prices allowing, hopes to boost that to more than \$300 million next year.

Some analysts, though, expect producers to ride out the storm easily. After five years of restructuring, many have much lower debt and operating costs. "The industry has adapted to this kind of price environment," agrees Larry Foster, chief editor of *Inside F.E.R.C.*, an industry newsletter. Maybe. But it doesn't have to like it.

By Wendy Zellner in Dallas



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WHAT HAS THREE ASTRONAUTS, PAUL ANKA, AND COLIN POWELL?

A Bakersfield law firm—staging its annual promotional bash

To most Californians, Bakersfield isn't much more than an exit off State Highway 99. Arid even in spring, it's a town of oil wells, tract houses, and miles of straight, dusty roads connecting cotton and fruit fields. But every October for the past 10 years, just as the hands take to the fields, California's 14th-largest city—population 202,000—transforms itself into a Woodstock for business and political groups.



WHO'S COMING TO BAKERSFIELD:

- ▶ Colin Powell
- ▶ Shirley MacLaine
- ▶ Henry Kissinger
- ▶ Jay Leno
- ▶ Neil Armstrong
- ▶ James Baker III

WHO HAS BEEN THERE:

- ▶ Four ex-Presidents
- ▶ Lee Iacocca
- ▶ Henry Winkler
- ▶ T. Boone Pickens
- ▶ Mario Cuomo
- ▶ Phyllis Diller



Clustered in a canvas tent large enough to contain a pair of football fields plus seven basketball courts, 14,000 people gather to listen to the likes of George Bush, Shirley MacLaine, and T. Boone Pickens Jr. wax eloquent for 30 minutes apiece. The topics range from NAFTA to women's roles in the workplace. "We suggest [speakers] have a lot of jokes," says George F. Martin, a onetime rock promoter who organizes the daylong talkathon. "It's a long day."

CASH FOR THE CHIEFS. It's also one heck of a promotional event. Martin is managing general partner of the local law firm Borton, Petrin & Conron, with 125 attorneys in 16 offices. "Our firm doesn't advertise on TV or radio or stand on its head and eat a bug to get business," says Martin. Instead, it stages the annual Bakersfield Business Conference.

The powerful virtually line up to address attendees—most of whom pay \$295 a head. In previous years, Martin has attracted the likes of Donald Trump and Lee A. Iacocca—with honoraria of up to \$60,000 apiece. In 1992, Ronald Reagan came. Last year, three former Presidents—Ford, Carter, and Bush—showed

fireworks, Jay Leno, and Paul Anka.

If all the hoopla means added business, Martin won't quantify it. But his firm, which specializes in business litigation and insurance defense, attracts an enviable audience to its shindig. Among attendees this year: MCA, Paramount Pictures, DHL Air Express, and HealthNet. State Farm Insurance alone has 80 tickets for its executives.

To Kay Meek, a fund-raiser at Bakersfield College who has attended 10 conferences, the confab has become a one-day escape to a celebrity-studded firmament. A few years back, she ran into former British Prime Minister Sir Harold Wilson on the way to the refreshment tent. Then there was General Norman Schwarzkopf's appearance, six months after Operation Desert Storm. "People gave him a five-minute standing ovation," says Rachel Gamez, who

owns three Mexican restaurants in town. "Tears were just running down people's cheeks."

None of this comes cheap. This year the "hard costs" of the day—everything besides employees' time, telephone charges, and other costs the firm absorbs—come to \$3 million. Of that \$250,000 goes to landscaping—which this year will feature a "moonscape near the beer garden" and a 7-foot-tall model of the lunar capsule sitting in a 100-foot-long reflecting pond. Another \$1.2 million or so goes to paying for tents and audiovisual services.

HICKSVILLE IMAGE. Martin says the conference usually breaks even, though last year, when he decided to give away a car at the last minute, it lost \$23,000. There are no plans for a car giveaway this year—but there will be a Ferris wheel.

About half of the conference's attendees come from Bakersfield, but enough spend the night to fill Bakersfield's 3,000 hotel and motel rooms. The convention bureau figures every overnight visitor brings in \$111. Perhaps more important, say officials, the event also counters the image of the city as Hicksville. "We could not have gone out and bought this kind of respect," says Chris T. Frank, executive vice-president of the local Chamber of Commerce.

So it's not surprising that the Bakersfield gathering is spawning competition. San Diego will host its own one-day cavalcade of bigwigs only a month after Bakersfield's. Other cities are mulling similar extravaganzas. After all, any event that can turn a dusty little California town into a mecca for the rich and famous invites imitation.

By Nanette Byrne in Bakersfield, Calif.



"The short march to the Euromarket."

"We have a lot of experience lead-managing large bond issues," says Daniela Leung, Corporate Finance, UBS. "So we know what it takes to ensure a successful transaction. A newcomer to the Euromarket - a government institution from China's Guangdong province - was a challenge to all of us. Our Hong Kong and London offices combined efforts to secure an investment grade rating from Moody's and a winning reception from the market."

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EDITED BY KEITH H. HAMMONDS

A MONEY-MARKET FUND GOES BELLY-UP

This won't bolster faith in the mutual fund industry: For the first time in at least a decade, a money-market fund is liquidating. Denver-based Community Bankers U.S. Government Money-Market Fund folded after investments in derivatives of government-agency securities went sour, leaving the fund's value at less than \$1 a share. The market for derivatives dried up last spring when interest rates began rising. Only 94 banks and bank holding companies were shareholders of Community Bankers, which had \$82 million in assets. Investors are

expected to receive 94¢ on the dollar.

COURTIN' TIME AT LOTUS AND ORACLE?

On the eve of launching what it had been calling a "Notes-killer," Oracle on Sept. 25 inked a deal with Lotus Development, maker of the popular Notes "groupware" program, to link Notes with Oracle's market-leading database. Now, insiders say Lotus CEO Jim Manzi and Oracle CEO Larry Ellison also are considering merging their companies. Insiders say a merger was discussed in late August and as recently as Sept. 20, when the two met at Ellison's Silicon Valley home, though Oracle USA President Raymond Lane dismisses the meetings as "idea talk." Combining the companies would make sense, analysts say, but there's at least one potential dealbreaker: One of the high-profile chiefs would have to step aside. Besides, Lotus may have a better offer: A source close to Lotus says AT&T wants a stake in the software maker.

AIG: CALIFORNIA, HERE WE COME

Maurice Greenberg is spreading his wings. On Sept. 28, his American International Group invested \$216 million in 20th Century Insurance, the California-based home and auto insurer. 20th Century needed the capital: It had been hit with \$815 million in claims from the January earthquake. The deal also represents Greenberg's biggest effort yet to pursue U.S. consumers, a market where AIG has been weak. With 40% of the California insurer in its pocket, AIG hopes to set up joint ventures in other states to sell auto policies—a business it began testing in 1992, when it bought a stake in Robert Plan, a Long Island, N.Y., insurer.

HEADLINER

McDONNELL'S NEW PILOT IS RARING TO GO

Harry Stonecipher is an impatient man. In a meeting at Sundstrand, where he held the top spot until he was named McDonnell Douglas' new chief executive on Sept. 26, Stonecipher sat quietly as executives debated how long they would take to implement a new strategy. Frustrated, he finally interrupted: "While you guys are sitting there looking at your calendars, I'm looking at my watch."

That sense of urgency caught McDonnell Chairman and CEO John McDonnell's eye. "We need to get to the next level," he says. "I believe [Stonecipher] will be a better

leader than I would be." The new CEO has his work cut out for him. Although McDonnell earned \$396 million last year before special charges, it faces a new challenge in its commercial-fighter-aircraft business. Meanwhile, McDonnell must figure out what to do with its underperforming commercial-aircraft division.

The 58-year-old former General Electric executive may be just what McDonnell needs. Stonecipher insulated Sundstrand from defense cuts by diversifying into new commercial businesses. McDonnell, he says, is "an opportunity for me to make a mark."

By Kevin Kelly



THE GAP TRIPS ON ITS UPSCALE STEP

What do women want? Lately, Gap merchandisers don't seem to know. On Sept. 26, the ubiquitous retail chain told analysts it expects same-store sales to be "modest" in September, after a 5% plunge in August. Turns out its bold move into higher-end, higher-margin women's fashion is fizzling. "Last year, they hit a home run on fashion. This year, they've struck out," says NatWest Securities analyst Robert F. Buchanan. Gap shares took a hit on the news but recovered Sept. 28, when analysts raised their rating on the stock.

LEHMAN DOES SOME MORE HOUSECLEANING

Lehman is trying to put to rest long-standing problems in its retail-brokerage division. On Sept. 27, Lehman

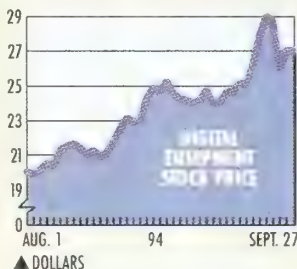
Brothers dismissed 100 retail brokers, slashing its U.S. force by a third. The cuts follow a two-year effort by Lehman to repair its reputation for overly aggressive sales tactics. Now, the firm says it wants to focus on its most profitable brokers and its wealthiest customers. The mass layoff "closes the book on the old Lehman Brother retail business and its methods," insists Robert Lunn, Morgan Stanley veteran who has headed Lehman's retail brokerage since July.

ET CETERA...

- ▶ Japanese giant Toshiba licensed IBM's PowerPC chip and computer technology.
- ▶ TWA says it could go bankrupt again if investor don't O.K. a restructuring.
- ▶ Nynex will freeze local phone rates in New York but earn unlimited profits.
- ▶ Clinton would keep Congress in session through December unless it approves GATT.

CLOSING BELL

NEW LIFE FOR OLD DEC



Is Digital Equipment headed for an IBM-like resurgence? Wall Street thinks so. Tough cost-cutting and asset sales are proving that CEO Robert Palmer is serious about turning around the computer maker. Since the June quarter's stunning \$1.7 billion loss, Palmer has raised \$500 million with asset sales and has slashed expenses by \$1.8 billion. To expand still-shrinking revenues, Palmer is heavily promoting Alpha AXP computers, though he still must contend with falling sales of DEC's high-margin VAX machines. Investors, afraid of missing an IBM-style stock rally, have driven DEC's shares up 43% since their July low. And the stock still looks cheap: At around \$27, it's just above the company's book value.

DATA: BLOOMBERG FINANCIAL MARKETS

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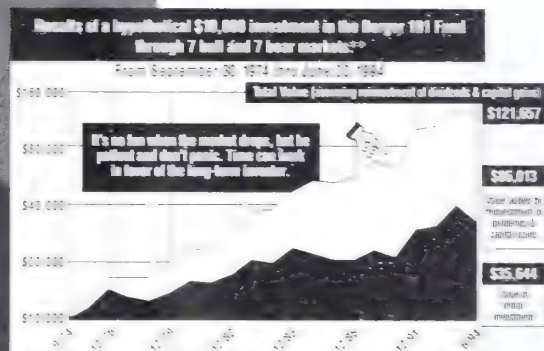
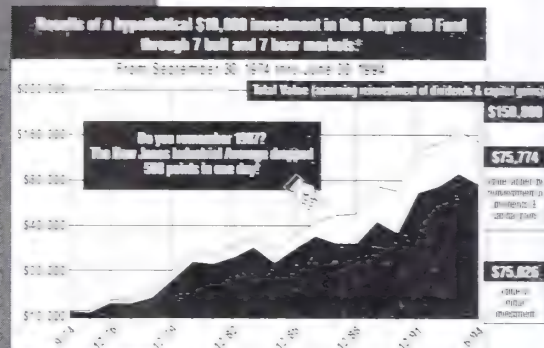
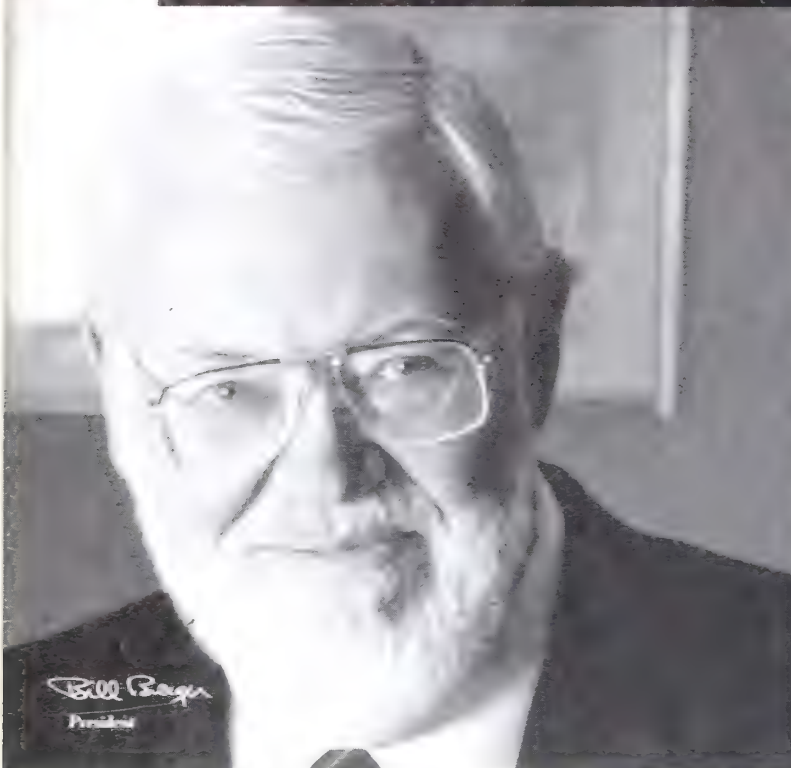
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¹ -4.7%, 19.5% and 17.5% are the respective 1-year, 5-year and 10-year average annual total returns for the period ending 6/30/94, for the Berger 100 Fund. ² 3.3%, 14.0% and 12.7% are the respective 1-year, 5-year and 10-year average annual total returns for the period ending 6/30/94, for the Berger 101 Fund.

THE FIRE OVER ILLEGAL IMMIGRANTS STARTS TO SINGE CLINTON

Former Representative Barbara Jordan, a paragon of Democratic liberalism, is the last person you would expect to set off a political firestorm for trampling on civil rights. Yet that's the charge she faces as head of the U.S. Commission on Immigration Reform.

On Sept. 30, Jordan's panel is to issue tough proposals for stemming the flood of illegal aliens. Among the controversial recommendations are new techniques to screen out undocumented workers—including a tamper-proof Social Security card—and the denial of government benefits to illegals. The report comes as a growing national outcry for aggressive action to deal with the influx of illegal immigrants—an ever-heavier economic burden on states. But liberal voices of tolerance, including the American Civil Liberties Union, say that Jordan's group is going too far.

These divisions put President Clinton in a bind. He can't ignore the clamor for a crackdown, but his response could trigger a backlash among Hispanics and Asian Americans who fear a resurgence of xenophobia and race discrimination.

TECH CHECK. Attorney General Janet Reno urges "to keep politics out of this and do it [implement] the right way." But that's close to impossible. Intense anti-immigrant sentiment erupted in California, the key state in the Presidential election. Polls show nearly one out of three voters (including 44% of Latinos) back a "Secure Our State" (SOS) ballot initiative, which would deny services to undocumented aliens and require state employees—such as teachers—to turn in suspected illegals. California, Florida, Arizona, New Jersey, and Texas also are suing the U.S. for \$4.4 billion laid out to jail criminal aliens and provide health and education benefits to other illegals—a cost that can be blamed on poor federal enforcement.

Against that backdrop, the Jordan Commission is sure to

fan the flames. Take its most controversial measure—a work-verification system—which Clinton is expected to embrace. Employers would have to check the status of prospective workers by matching a high-tech Social Security card against a computerized list. The card would replace a cumbersome system under which employers often are duped by forged documents when they fill out work-verification forms. "Any way to get rid of the forms is automatically appealing," says Peter J. Eide of the U.S. Chamber of Commerce.

But immigration advocacy groups and civil libertarians vow to fight the card. They say it could provide the means to impose further restrictions on aliens, such as the denial of benefits under California's SOS ballot initiative.

Meanwhile, Congress is raising the prospect of going beyond Jordan's panel by curbing legal entries before the 1996 election. On Sept. 21, Senator Richard C. Shelby (D-Ala.) proposed reducing immigration by two-thirds—to 325,000 annually—for five years. That's one remedy both business and immigration groups oppose. Limiting imported labor, would be "troubling for employers," says Daryl R. Buffenstein, an Atlanta immigration attorney who represents corporations. Frets Karen K. Narasaki, a lobbyist for the Japanese American Citizens League: "No matter how outrageous the provision, if it's anti-immigrant, it would pass."

So far, Clinton has plied a middle course. He's beefed up the border patrol and cracked down on alien smuggling, both reasonable measures. But as the immigration debate reaches a crescendo, he will be subject to more extreme demands to close America's doors. If the President is to resist calls to erect "Not Welcome" signs to the legal immigrants who have been a source of national strength for generations, he will have to do more to satisfy the clamor for a harder line on illegals.

By Catherine Yang



JORDAN: A WORKER I.D.?

ITAL WRAPUP

ADMINISTRATION

Commerce Secretary Ronald H. Brown hopes to trade in his salesman's sample case for new pinstripes. Inspired by his triumphant trade mission to China in late August, Brown is vying to replace Warren M. Christopher as Secretary of State. Brown tells confidants that with economics driving U.S. foreign policy now, he has given himself to be a preeminent practitioner of "commercial diplomacy." Indeed, his success in prodding China to resume human-rights talks with the U.S. contrasts with Beijing's snub of Christopher's human-rights pleas on an earlier trip. Just in case he doesn't get

the new job, Brown is planning a high-profile trade mission to India in January and a China trip in the spring.

THE POSTAL SERVICE

Postmaster General Marvin T. Runyon could lose his job over something as innocent as a cancelled stamp. Last May, 82 senators urged Runyon to print a POW-MIA stamp, but an advisory board—taking its cue from the Postmaster—recently gave the idea a thumbs down. Now, irate senators, already unhappy with Runyon's performance, are demanding that he be fired. When the Postal Board of Governors meets on Oct. 3, it will feel pressure to cancel Runyon's job.

REGULATION

The Federal Communications Commission won praise last year for saying it would stop giving away airwaves—and start selling them. But now it is retreating. At issue are cellular licenses the FCC awarded for free in the 1980s but later reclaimed as systems weren't built. Most licenses are for worthless rural zones, but some could fetch millions, such as those for parts of Los Angeles. Chairman Reed E. Hundt proposed selling them, but was outvoted 2 to 1 on grounds that it's unfair to change rules. Now the FCC has a full five members, so Hundt may force another vote by yearend.

FACING REALITY IN JAPAN TRADE

America's decades-old policy is doomed to failure. This may work

For months, the big question between the U.S. and Japan was whether the two sides could reach agreement in their so-called framework talks by Sept. 30. If not, would Washington invoke a trade-law provision called Super 301 and impose sanctions? How would Japan react? Would currency markets continue to "punish" Japan by pricing the yen even higher, thus making its exports more expensive?

In one version or another, this Kabuki dance has been played out repeatedly for decades. But why does the U.S. trade deficit with Japan continue to grow? This year, it's expected to reach \$61 billion, up from \$41 billion in 1990 (chart). During the same period, the yen has appreciated 39% against the dollar. A strong yen simply hasn't solved the problem. Nor is it likely to.

Furthermore, despite all the hoopla, even Administration officials admit that success in the sector-by-sector talks won't do much to reduce Japan's trade surplus. "I don't think anyone in the Administration believes these negotiations are going to lead to a substantial reversal of our trade deficit in the short term," says Jeffrey E. Garten, Commerce Under Secretary for international trade. The Japanese concur.

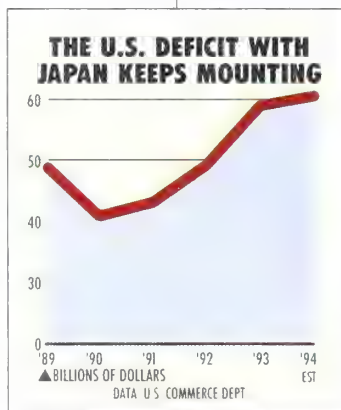
REAL PRESENCE. Everybody also seems to know that sanctions, in the form of punitive tariffs or quotas, would deprive U.S. industry and consumers of vital products. These include liquid-crystal displays, VCRs, and fax machines—not to mention the Lexus. Despite all of Washington's threats, it's not politically rational to shut off the flow of such products. Besides, some goods are as-

sembled at Japan's transplants in the U.S., so the traditional water's-edge trade policy is out of date. That also helps explain why the strong yen doesn't work like the theory says it should.

In short, the failings of the traditional U.S. approach to Japan are all too evident. That suggests the need for a thorough rethinking of U.S. policy vis-à-vis Japan. The goal should be a serious, long-term focus on the economic imbalance, not episodic trade brinksmanship and yen-dollar crises.

First and foremost, the U.S. government and industry should work together to promote more investment into Japan. That means revising tax laws and technology-transfer rules that actually discourage U.S. penetration of technology niches. Trade penetration, particularly in Japan, requires a

physical presence, including control of distribution channels. Yet Japan has the lowest level of per capita foreign direct investment in the industrialized world. For years, Japan discouraged foreign investment to protect its own industries. Now, however, the yen has soared so high that acquiring land and doing business in Japan seems prohibitively expensive to most outsiders. Japan doesn't deserve all the blame, however. Ever since its bubble burst and other parts of Asia started growing faster, increasing numbers of U.S. companies have decided to bypass it and go where the pickings are easier. Some U.S. executives, enamored of China or India or Mexico, are simply writing off the country, and the Commerce Dept. has been egging them on by promoting big developing markets—but not Japan.



TOWARD A NEW JAPAN STRATEGY

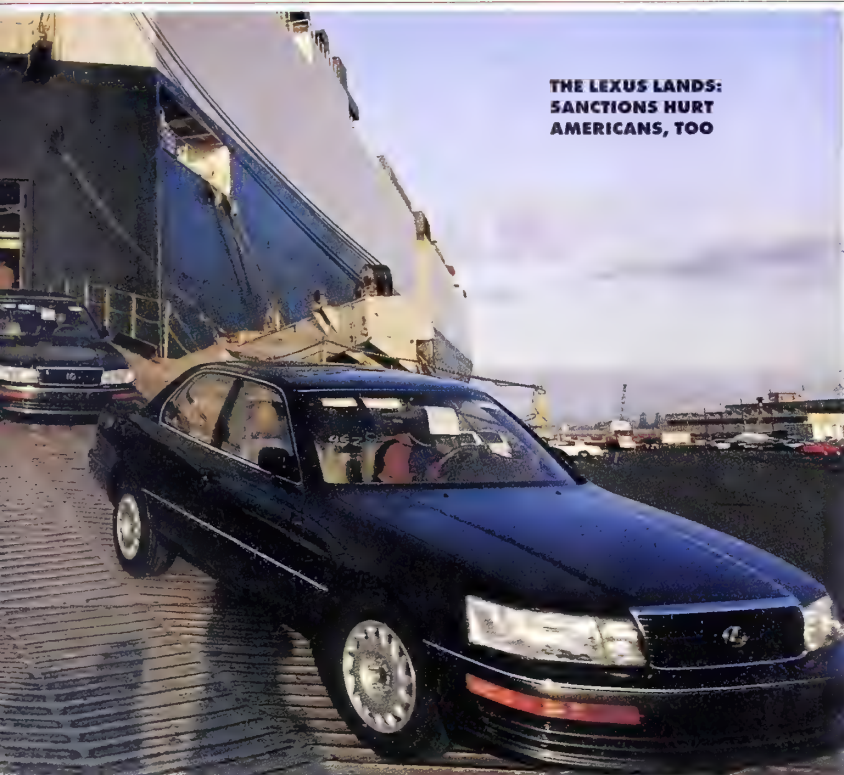
DATA: BUSINESS WEEK

1 Create a powerful Japan strategy within White House to carry out a term, consider strategy. Should be staffed by experienced Japanese specialists.

This could prove to be a serious strategic error. Not only is Japan the world's second-largest economy, but it also is home to many globally competitive manufacturers. Not to compete with the Japanese on their turf gives them extra breathing room and deprives America of market intelligence. "Our Japanese competitors produce good products, and we can't be successful in Asia unless we're successful in Japan," says Douglas R. Browning, vice-president for finance at Procter & Gamble Far East Inc.

"DOWN THE ROAD." To spur the emergence of more Motorolas and Microsofts with strong positions in their niches, the U.S. government should insist on working aggressively with Tokyo to encourage inward investment. Japan's Ministry of International Trade & Industry has taken a few modest steps to ease entry by foreigners, such as

The U.S. needs a serious, long-term focus on t



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promote U.S.
investment in
help crack
that means
U.S. tax and
technology-transfer
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3 In areas where U.S. manufacturers depend on Japanese suppliers, create more government-industry strategies to spur U.S. competitors. Model: Sematech.

4 Establish more industry association offices in Tokyo to disseminate data about standards and regulatory issues. Model: The American Electronic Assn.'s office.

5 Link treatment of Japanese companies in U.S. with market penetration in Japan. If a Japanese company is blocking access in Japan, it should feel pressure in the U.S.

ting foreign-access zones with limitations and services. But much is needed to attract the investment necessary to really make a dent in surplus.

Besides incentives, it's time for the U.S. to put more emphasis on Japanese regulation again. Deregulation has been a buzzword in Japan for more than a year, but U.S. and Japanese negotiators haven't held any serious talks on the subject. Says U.S. Ambassador Robert F. Mondale: "That's still down the road." Why? According to one American official, the U.S. hasn't yet figured out what it wants to ask of Japan, or how.

How should Washington orchestrate a more gauged, more potent approach toward Japan? Glen Fukushima, vice-president of the American Chamber of Commerce in Japan and a former U.S.

trade negotiator, argues for the creation of a Japan Office within the White House. Earlier this year, Bill Clinton read and circulated among senior Administration officials a paper in which Fukushima made his case. But so far, nothing has happened.

A less ambitious alternative might be to improve the Japan data-collection and monitoring services of the U.S. Trade Representative's Office and the Commerce Dept. This idea is pushed in a new book called *Opening Japan* from the Economic Strategy Institute think-tank in Washington. The authors also urge creation of a task force consisting of members of Congress, senior trade officials, and American executives to make recommendations each year as to what must be done in policy toward Japan.

Part of this new and more sophisticated

approach would be an increased focus on what Japanese companies are doing in the U.S. and how that affects trade. Rather than displacing imports, at least some of Japan's stateside factories encourage them. The Commerce Dept. estimates, for example, that 73% of Japanese imports into the U.S. go through facilities and distribution networks owned by Japanese. That's why seemingly obscure fights over domestic content and supplier networks are so important.

It's also key to link treatment of those American subsidiaries with trade goals in Japan. It makes little sense, for example, for Japanese construction companies to be winning about \$3 billion in contracts from U.S. government agencies, when the U.S. is stonewalled in the construction sector in Japan. The same lesson applies in other industries, such as telecommunications.

Likewise, how closely linked are American trade goals with the Clinton Administration's technology-promotion policies? Washington has made progress on redirecting the federal weapons labs toward commercial purposes and on funding some promising "critical" technologies. But the trade hand of the U.S. government and the technology hand often don't know what each other is doing. There is no mechanism for coordination.

NOT JUST PRESSURE. Not to be forgotten, of course, are the macroeconomic forces at work in sustaining the U.S.-Japan imbalance. The U.S. saves too little and consumes too much. For Japan, it's vice versa. So Americans need to continue to make progress on their budget deficit, and they need to keep pressing Japan to stimulate its economy. Tokyo's recent decision to cut taxes for three years is positive because it should increase consumption. But by itself, that probably won't have a big impact on Japan's import of U.S. goods.

In the end, the U.S. shouldn't forsake pressure tactics of the traditional sort. But it can't rely exclusively on them, or on the hope that such macroeconomic factors as a strong yen or slightly improved growth in Japan will narrow the trade gap. A more comprehensive, systematic approach is required. To redress an imbalance that's been building for years, the U.S. will have to attack the very structure of an increasingly complex relationship.

By Robert Neff in Tokyo, with Douglas Harbrecht in Washington

Balance—not trade brinksmanship

**It's nice to know the
youngest in the sky. In
the mechanics train
doctors. It's nice to see
such good care of itse**



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care of you.**

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IS THE JINX FINALLY OFF JAGUAR?

Ford is about to learn if new models can redeem a \$4 billion investment

At a Sept. 26 reception in London's Mayfair district, customers of a local Jaguar dealership quaffed champagne as they eyed the British carmaker's first new model in eight years. The guests loved the curvy restyling of the XJ sedan, but even these loyalists wondered if it was free of the mechanical glitches that have often made owning a Jag an exercise in upper-class masochism. "I've had a dreadful experience with my current car," confided Martin S. Harrison, whose Jaguar was in and out of the shop for five years before it ran smoothly. "Only time will tell if this one will be more reliable."

Ford Motor Co. certainly hopes it will be. Since buying Jaguar Cars Ltd. for \$2.6 billion in 1990, it has spent plenty more to streamline factories and absorb heavy charges for massive layoffs. Total investment by Ford so far: almost \$4 billion. Total profits: none.

As the first new product to come out of Jaguar since the takeover, the XJ sedan must reverse that dismal trend. The company also plans to roll out a new sports coupe in 1996, followed by a smaller, higher-volume sedan to rival BMW's 5-series car in 1997. But before all that can happen, explains Jaguar Chairman and CEO Nicholas V. Scheele, "we've got to return Jaguar to the black on the back of this car."

A SLEEK BODY. Fortunately for Scheele, analysts think the XJ will increase Jaguar sales by 7,000 cars in 1995, to 39,000 worldwide, and turn at least a small profit on estimated sales of \$2.2 billion (charts). They figure the XJ, which succeeds the eight-year-old XJ6 and will probably account for 85% of sales, will attract buyers with a redesigned body. The rounded styling harks back to the first Jaguars designed by Sir William Lyons, the company's founder.

Just as important, a 249-horsepower engine, designed for greater reliability and strength, should be a big selling

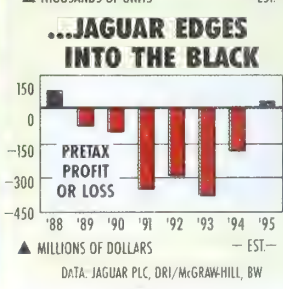
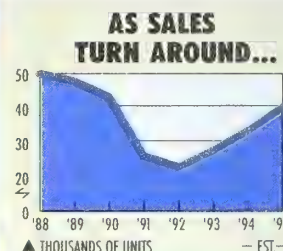
point. Jaguar has overhauled the car's temperamental electrical and cooling systems and changed some 2,000 parts. "This is not just a face-lift," says D. Garrel Rhys, director of the Center for Automotive Research at Cardiff University. "It's a major reworking." A limited-production version of the sedan, the XJR, sports a 326-horsepower engine.

The profitability of the XJ, which will sell for \$53,400 and up in the U.S., will also benefit from Ford's leaner production methods, which have lowered the breakeven point at Jaguar from 50,000 to about 35,000 cars a year. Ford has replaced the 40-year-old, two-track assembly line at the Browns Lane plant in Coventry with a single line that can pro-

duce 25% more cars. Ford's buying clout also has lowered the cost of parts for Jaguar. Besides its regular quality control, Jaguar now has special teams scour 1 car in 10 for problems.

Although it's too early to gauge customer reaction, Jaguar's dealers are hoping the new model will bring back the glory days. They also appreciate Ford zeal. When members of Jaguar's U.S. National Dealer Advisory Council were asked for input on the new XJs in 1991, they insisted the carmaker needed to boost quality, says Martin P. Bennett, owner of Thoroughbred Motorcars Inc. in Nashville and head of Jaguar's National Dealer Advisory Council. "Fortunately, we were pushing on an open door," he says.

STRATEGIC RISK. Still, Jaguar faces plenty of challenges as it battles its way back into the crowded luxury market. BMW and Mercedes will both begin producing in the U.S. soon, lowering their costs and bringing them closer to their key market. Jaguar itself is likely to build its small, higher-volume sedan code-named the X200, on a Ford platform, and shift most of the production to the U.S. This strategy increases the risk of cheapening the Jaguar brand



duce 25% more cars. Ford's buying clout also has lowered the cost of parts for Jaguar. Besides its regular quality control, Jaguar now has special teams scour 1 car in 10 for problems.

The efforts have been slowly paying off, even before the new XJ was launched. Jaguar's sales in the U.S., its single biggest market, jumped 22% in the first eight months of 1994. True, they were fueled by special leasing deals and other incentives. But Jag's share of the top tier of the American market has nearly doubled, to 9.9%, from 1992. More important, Jaguar's ranking in the J.D. Power Associates Inc. 1994 customer satisfaction index has jumped to 10th,

but Scheele swears that drivers won't be able to detect any difference.

A larger question is how long it will take to prove that Jaguar was a good investment for Ford. Most analysts believe that even if the new XJs are a big hit, Ford won't realize a decent return on its \$4 billion until the turn of the century—at the earliest. Some competitors are more skeptical. "Jaguar is a great name in the auto industry," says the chairman of a rival German auto company. "But I wonder if Ford will ever get its money back." Ford and its rivals will soon start finding out.

By Julia Flynn in Coventry and James B. Treece in Detroit, with bureau reports

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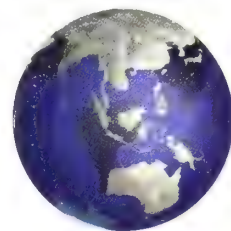
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[†]Morgan Stanley Capital International, 1993. [‡]*Pacific Economic Digest*, December 1993.

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CANADA: WHY CHRETIEN STANDS 'ON THE EDGE OF A PRECIPICE'

Bill Clinton must envy Canadian Prime Minister Jean Chrétien's popularity: After nearly a year in office, the affable Chrétien still enjoys a 60% approval rating. But now, it's crunch time. With international investors breathing down his neck, he is finally being forced to grapple with Canada's two toughest problems: massive debt and resurgent Quebec separatism.

In early October, Chrétien's government is expected to unveil long-delayed proposals to overhaul Canada's costly social safety net. Cutbacks are likely to hit everything from hefty unemployment benefits to subsidized college educations. So central are such programs to Canadian identity that Chrétien's plans are sure to spark a huge fight. But Canada can no longer afford the massive deficits piled up by social spending, business leaders warn. After a "quarter century of fiscal abuse," says A.L. Flood, CEO of Canadian Imperial Bank of Commerce, "we stand on the edge of a precipice."

RED INK. The danger of falling off was signaled recently by Moody's Investors Service, which stripped Canada of its AAA rating on foreign-currency debt. In effect, Chrétien's hand is being forced by what Sherry Cooper, chief economist at Nesbitt Burns Economics, calls "one of the worst deficit and debt records in the industrialized world" (chart). The debt has made Canada highly vulnerable to the opinion of Wall Street investors and other foreigners who finance more than 40% of it. With 10-year real bond yields close to 9%, vs. 4.7% in the U.S., Canada's debt-service costs, which already devour 25% of Ottawa's budget, are ballooning.

Quebec's separatists are digging in, however, to resist Chrétien's financial fix. They took power on Sept. 26, and they are likely to view slashes in joint federal-provincial social

programs as unwarranted interference from Ottawa. New Premier Jacques Parizeau is already vowing to boycott the talks that Chrétien hopes will build a national consensus for his reforms.

In English-speaking Ontario, too, socialist Premier Bob Rae will oppose cost-cutting plans on the eve of the election he must call in 1995. And organized labor, which is more powerful in Canada than in the U.S., is hopping mad.

DIRE VISION. What business fears is that the economy could hit the wall as soon as 1997 if spending isn't cut sharply now.

Warns J. Edward Newall, CEO of Nova Corp. of Alberta and chairman of the Business Council on National Issues: "If we continue on our present course, our deficits will skyrocket out of control" in the next recession. That could spark a financial crisis in which "we will lose control over our own destiny, and our economic action plan will be dictated by the International Monetary Fund," he adds.

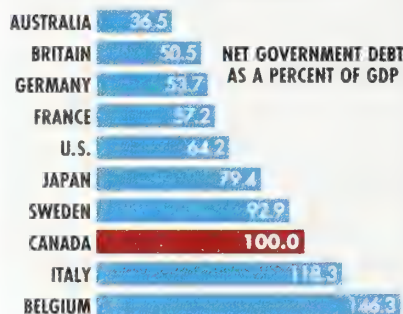
To head off that danger, Finance Minister Paul Martin Jr. vows to slash the deficit to around \$19 billion, or 3% of gross domestic product, by fiscal 1996 "come hell or high water." To get there, Chrétien is expected to suggest major reductions in Canada's \$13 billion unemployment-insurance program and deep

cuts in federal grants to universities. While he may skirt a direct attack on the health-care system, federal aid cuts are already forcing provinces to close hospitals and curtail services.

International investors are watching closely. Despite the high yields on Canadian debt, Canada's dollar is trading around U.S. 74¢, close to its eight-year low of around 72¢. That's stark enough evidence that the nation's fiscal mess is exacting a high toll—no matter what Chrétien decides to do.

By William C. Symonds in Toronto

DOWN THERE WITH THE WORST OF THEM



DATA: NESBITT BURNS ECONOMICS, OECD

GLOBAL WRAPUP

ANOTHER BLOW TO MEXICO

Mexico's transition to a more open democracy is turning out to be bloodier than anyone had imagined. On Sept. 28, in this year's second shocking assassination, a gunman killed José Francisco Ruiz Massieu, 48, the secretary-general of the ruling Institutional Revolutionary Party (PRI). Last March, the PRI's presidential candidate, Luis Donaldo Colosio, was killed by a gunman while campaigning in Tijuana. Ruiz Massieu, a close collaborator and former brother-in-law of President Carlos Salinas de Gortari, was machine-gunned in daylight in Mexico City. He was slated to be the PRI's majority

leader in the Chamber of Deputies.

The murder dimmed a surge of optimism over prospects for stability following August's elections—and sent jitters through Mexico's *bolsa*. Observers believe the killing reflects a battle between PRI reformers and hard-liners for party control—a contest sharpened by the vast opportunities for corruption open to officeholders. Ruiz Massieu had been working closely with President-elect Ernesto Zedillo Ponce de León on ways to reform the party so that it would no longer be closely linked to the government, as it has been during 65 years of monopoly rule.

By contrast, PRI hard-liners viewed Zedillo's victory in the Aug. 21 elec-

tions as justification for maintaining the status quo. Just one day before Ruiz Massieu's death, the PRI's reform wing had announced the start of consultations with PRI members on steps to modernize the party. Further challenging the old guard, election officials a week before had overturned PRI victories for the Monterrey mayorship and for two federal Congress seats, awarding the posts to candidates from the two major opposition parties.

Miguel Angel Granados Chapa, one of the six citizen board members of the Federal Electoral Institute that oversees elections, minced no words: "This is part of a power struggle within the PRI."



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RUSSIA'S NEW CAPITALISM

IT'S STILL CHAOTIC, BUT PRIVATE COMPANIES ARE FORGING A VITAL ECONOMY

In 1990, some recent graduates of the Moscow Aviation Institute gathered for a gripe session on the Soviet airline industry. They found plenty to talk about. Aeroflot, the huge state monopoly, was an international joke, with atrocious service and a plummeting safety record. It was hardly the place where the young grads, whose average age was 27, wanted to spend the next 35 years. So why not start an airline, someone suggested.

Four years later, this small group of dreamers runs Transaero, an airline that is growing with extraordinary speed. Starting with just one flight a week, the carrier now operates leased Boeing jets on 75 flights a week to such diverse spots as Tel Aviv and Tashkent. With British Airways and Air France training its flight attendants, Transaero plans to double its flights next year. By 1997, the upstart hopes to be taking Russian tourists to Disney World, near Orlando. Says Transaero's President Alexander Pleshakov: "We have been able to achieve the almost-impossible in Russia: offer first-class service."

Transaero is just one of thousands of new, private Russian companies that are emerging from the collapsed Soviet economy. In a number of key sectors—transportation, retailing, high tech, finance, and many others—Russian entrepreneurs are laying the foundations of a private economy.

The new entrepreneurs have deliber-

MANUFACTURING

Alexander Panikin
Head, Paninter

REVENUE: \$3 MILLION

Workers put out a million pieces of clothing a year—and earn twice what a state plant would pay



...y sought low profiles to avoid shakedowns from ashnikov-toting mafiosi to escape greedy and corrupt tax inspectors from Moscow. Some of them have to establish their security forces. And because Russia does not yet have fully developed accounting and disclosure standards, few private-sector operators are eager to close their revenues. But they have already built substantial businesses with thousands of employees and profits in the tens of millions.

These companies aren't likely to absorb workers in their 50s or 60s who have been subject to dramatic cutbacks in their working hours—and pay—at failing state enterprises. But the evidence is growing that the efforts of these businesspeople may be just enough to bring Russia's drastic economic slide to a halt. Even the early pessimistic official numbers show production bottoming out, inflation falling, and personal income and savings rising. Even the continued uncertainty over the value of the sinking ruble hasn't been great enough to stamp out an increase in private-sector activity. "We are witnessing a turnaround," says Igor Gaidar, the radical reformer and former Deputy Prime Minister who fell from power when voters rejected his shock therapy in 1993.

JUNG MAVERICKS. Everyone acknowledges that Russia still has a long way to go. Roughly 60% of the measurable econ-

omy, including some sectors, is both the old state-owned and the newly privatized. The economy is healthy, but it's larger than most people think," says Daniel Yergin, a specialist in Russia and president of Cambridge Energy Research Associates Inc. Russia's highly successful privatization program has been a big factor. President Boris Yeltsin and his cohorts have stuck with this program, shrugging off both domestic and Western carping. In just under three years, more than 70,000 state enterprises have been at least partly privatized,



SERVICES

Alexander Pleshakov
Founder, Transaero

REVENUE: \$19 MILLION

The airline operates leased Boeing jets on 75 flights a week and plans to double that soon

and at least 18,000 new private companies have been formed. By comparison, notes Roger Gale of International Finance Corp.'s Moscow office, "there were less than 8,000 companies privatized worldwide" from 1980 to 1989.

The result has been sweeping change in large swaths of the economy. Some 90% of small businesses are now in private hands. Two out of every three workers in core industries now work

for private companies. Shareholders and managers have been empowered.

Spearheading the big switch are a diverse group of young Russians. Some are maverick entrepreneurs who got started in dusty backwaters of the old Soviet empire. Others are well-connected Muscovites with backing from the former Communist Party or the KGB. Many are academics or engineers who became fed up with the pin money the state system paid them.

It's not easy to measure exactly how much this group is contributing to the

economy, officially pegged at \$130 billion. Everyone agrees their output doesn't show up in the official numbers. "The cash economy is huge: 40% to 50% of income is unreported," says Alexander S. Bevez, executive director of the Civil Society Foundation. Russia is like a typical Latin American country with 90% poor, 10% middle class, and 1% super-rich. But the situation is dynamic. He adds: "The middle class is growing rapidly, and statistics don't show its strength."

SPREADING CASH. The new business class tends to be staunchly nationalistic. In politics, they spread their money around centrist and reformist parties—shunning the former Communists as well as such hardliners as right-wing extremist Vladimir V. Zhirinovskiy. The entrepreneurs aren't anti-Western, but they are learning to use their newfound political clout to protect their turf from foreign competitors.

Last year, for example, the big rubles that bankers contributed to Gaidar's reformist Russia's Choice party helped persuade him to slap restrictions on foreign banks. Entrepreneurs are also lobbying hard for more favorable tax regimes and commercial codes.

Still, the emergence of a legitimate private sector is creating more opportunities than barriers for Western interests. After years of disappointment, U.S. and British money managers, including PaineWebber, Salomon Brothers, and London-based Robert Fleming and Morgan Grenfell are setting up funds in Russia and scouring the country for buying opportunities. This year foreign invest-

RUSSIA IN TRANSITION

THE OLD ECONOMY IS WEAKENING...

- ▶ Heavy manufacturers, with \$48 billion in unpaid bills, are screaming for government credits
- ▶ The agricultural sector is in deep trouble, facing the worst harvest in decades
- ▶ The weapons industry, lacking orders, is in crisis
- ▶ Factories are slashing workers' hours and pay

60% of the economy, both public and private, is troubled

...BUT A PRIVATE SECTOR IS EMERGING

- ▶ 90% of small companies are in private hands
- ▶ 80% of service-sector companies are private
- ▶ Overall, 70% of the total economy is privately held
- ▶ Employment is rising rapidly; two-thirds of jobs in core industries are in the private sector

40% of the economy, both public and private, is growing

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ment should reach \$4 billion, three times what it was in 1993, says privatization boss Anatoli Chubais.

About 15 blue-chip companies in Russia, including the nationwide phone company Rostelecom, utility United Energy System, and oil giant Lukoil are already drawing in cash from such savvy investors as CS First Boston Group Inc. Big money managers such as Mark Mobius, portfolio manager of the Templeton Emerging Markets Fund, are also attracted to the Russian private sector. Mobius thinks Russia's huge privatization program could eventually help it to rival China as an investment play.

STATURE GAP. What distinguishes the new private-sector entrepreneurs from the con men and thugs is that they are making real investments and creating stable employment. Many of their owners, including Alexander S. Panikin, proprietor of a Moscow-based textile company called Panintex, are taking advantage of an abundance of cheap, skilled labor. Panikin, a 44-year-old former theater manager, made enough money trading goods in the Gorbachev era to set up a tiny establishment with six sewing machines in 1989.

Now he employs 1,000 workers who tend top-quality German looms and churn out a million pieces of clothing a year. Panikin doesn't squeeze his employees the way some of the new entrepreneurs do. He pays them twice the usual \$100-a-month state rate—if the state pays at all. "To sell oil abroad is simple," he explains. "You bribe someone in government. But to produce and manufacture something—that takes a lot of talent and work."

There are also a host of companies taking advantage of Russia's large cadre of talented programmers and software engineers. Moscow-based Paragraph, for instance, has supplied the technology for handwriting-recognition software for Apple Computer Inc.'s Newton Notepad. "At the time, they



Boulder, Colo., buy 50% stake. Today, working out of a casual Moscow office, Paragraph specializes in such rarefied applications as multimedia and digital photography.

One of the most compelling questions about the new private-sector players is whether they will grow enough in stature to emerge as big players in heavy industries and energy. So far, the answer is that upstarts haven't been able to achieve that size. But they are able to take pieces of the old system and fashion them into something new—and private. That is definitely the case in the energy field, where the government plans to carve 10 new giants out of its dying state dinosaurs.

So far, the most intriguing of these new entities is Lukoil, which is a world leader in oil reserves. Located in a beautifully renovated brick building across the street from Moscow's famous Sandunovskiy steam baths, the company now produces about 15% of Russia's

oil output and 25% of all the oil in Western Siberia, the nation's most important oil patch.

CREATIVE FINANCING. While the state still holds a majority stake in Lukoil, it is gradually relinquishing control. CS First Boston is one of the foreign investors with an early position. Lukoil President Vagit Alekperov, a 44-year-old former oil and gas deputy minister, says that Lukoil aims to be a world player like Royal Dutch/Shell Group or Mobil Corp.

Although it still clearly has shortcomings in management and technology, Lukoil is pushing its way into big-time projects as an instrument of Russian foreign policy. Earlier this year, the Kremlin employed some hard-knuckled bargaining to persuade the government of Azerbaijan to grant Lukoil a 10% share in a \$9 billion project offshore in the Caspian Sea led by British Petroleum Co. and Amoco Corp.

Many observers thought that the biggest obstacle to the emergence of a private sector in Russia would be fi-

BANKING

Mikhail Hodorovsky
Head, Menatep Bank

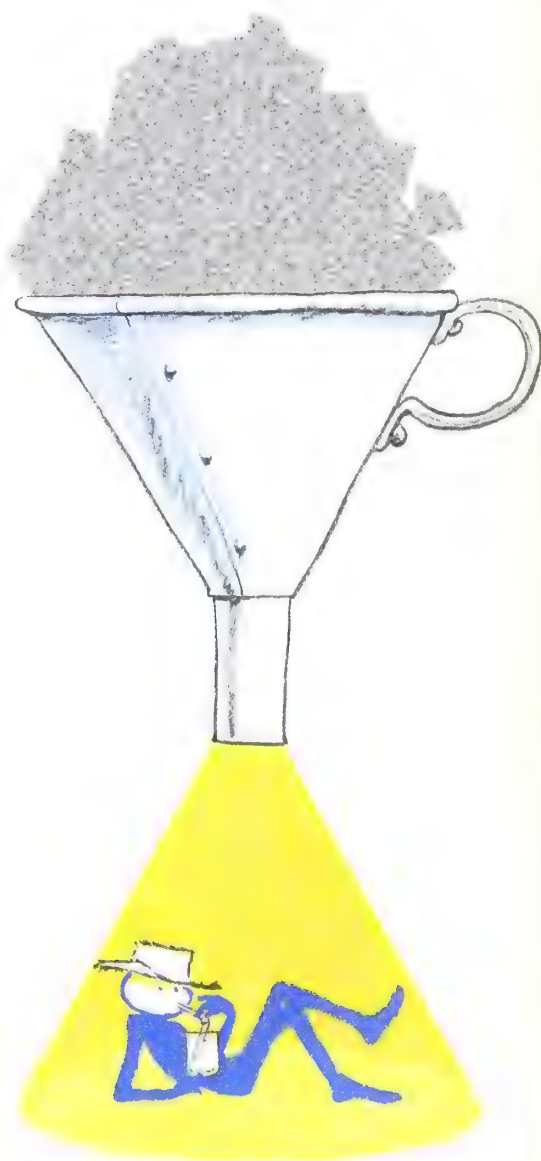
ASSETS: \$1 BILLION

The 31-year-old banker has carved out a niche by lending to textile factories

had, and still have, the best cursive handwriting recognition available," says Sandy M. Benett, a senior engineering manager in Apple's Personal Interactive Electronics Group.

Paragraph's workers shuttle from Moscow to their U.S. office in Sunnyvale, Calif. The company was formed by a group of blue-jeaned computer jocks from Moscow State University who got together on weekends to teach children about the machines. They have let Matrix I, a venture-capital group based in

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TECHNOLOGY

Software Developers
Paragraph

REVENUES: \$4.5 MILLION

Apple licensed technology for the Newton from this outfit, which now specializes in multimedia

nancing. Just three years ago, Russians had no securities markets and one of the world's most hidebound banking systems.

Surprisingly, however, private-sector Russians have taken to stock trading and creative financing with abandon. Some 3,000 commercial banks have been formed. To be sure, some aren't banks at all but shady finance companies bound to tumble at any time. The most notorious example is MMM, which ran a hugely popular pyramid scheme that fell apart in July.

TIGHT WITH THE KGB? But others are offering valuable services. Six-year-old Inkombank, for instance, has become the leader in offering personal banking services, such as Visa credit cards, and also has close ties to big industries, such as oil. It now has \$1.7 billion in assets, 4,500 employees, 15 Moscow branches, and offices in 23 Russian cities as well as Frankfurt and Geneva. The company reports \$43 million in earnings for its last fiscal year.

Like many of the startups in other industries, Inkombank was the brainchild of a young crowd. The average age of its directors is 33. "Younger people are better able to adapt to fast-changing conditions," says the bank's chairman, 38-year-old Vladimir V. Vinogradov. A stocky fellow with piercing blue eyes, he holds court in his office with a huge Russian flag on the wall and a formidable plainclothes bodyguard nearby.

Vinogradov is part of a small elite of wealthy young Russian bankers who got started in the late 1980s and managed to stick it out. Mikhail B. Hodorovsky, 31, who heads the \$1 billion Menatep Bank, is another star in this group. So is 41-year-old Vladimir A. Gusinsky.



Besides being MOST Bank's president, Gusinsky also founded and owns the liberal newspaper *Sevodnaya* ("Today") and the new Independent Television Network.

The successful bankers have all carved out very specific niches for themselves. Menatep lends to textile factories, while MOST specializes in construction and high technology. Another important player, Stolichny Bank, finances the aviation industry.

Both Menatep and MOST have long

been rumored to have tight ties with former KGB officials or to have gotten started with Communist Party money—charges both bank presidents deny. "Do you think the [former] KGB chairman is going to loan money to a 25-year-old boy?" asks Hodorovsky, who has the pelt of a rare Ussuri tiger on the floor of his office.

It doesn't seem to make any difference—even if the charges are true. These youthful financiers are bullish on the long term. Hodorovsky, for example, predicts his bank's assets will grow

at least ten times by 2000, despite a widely expected shakeout of weaker banks. They will be an important tool for channeling Russian savings into the companies that can build a more stable economy.

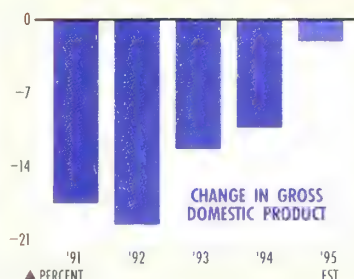
Russian companies may soon be able to use the rapidly developing securities markets to raise capital. Right now, organized trading is limited to only about 15 of the biggest companies. But that is about to change. Russia's new securities commission is working with KMPG Peat Marwick under contract for the U.S. Agency for International Development to develop a

CAN RUSSIA PULL OFF AN ECONOMIC TURNAROUND?

INFLATION HAS DECLINED SHARPLY...



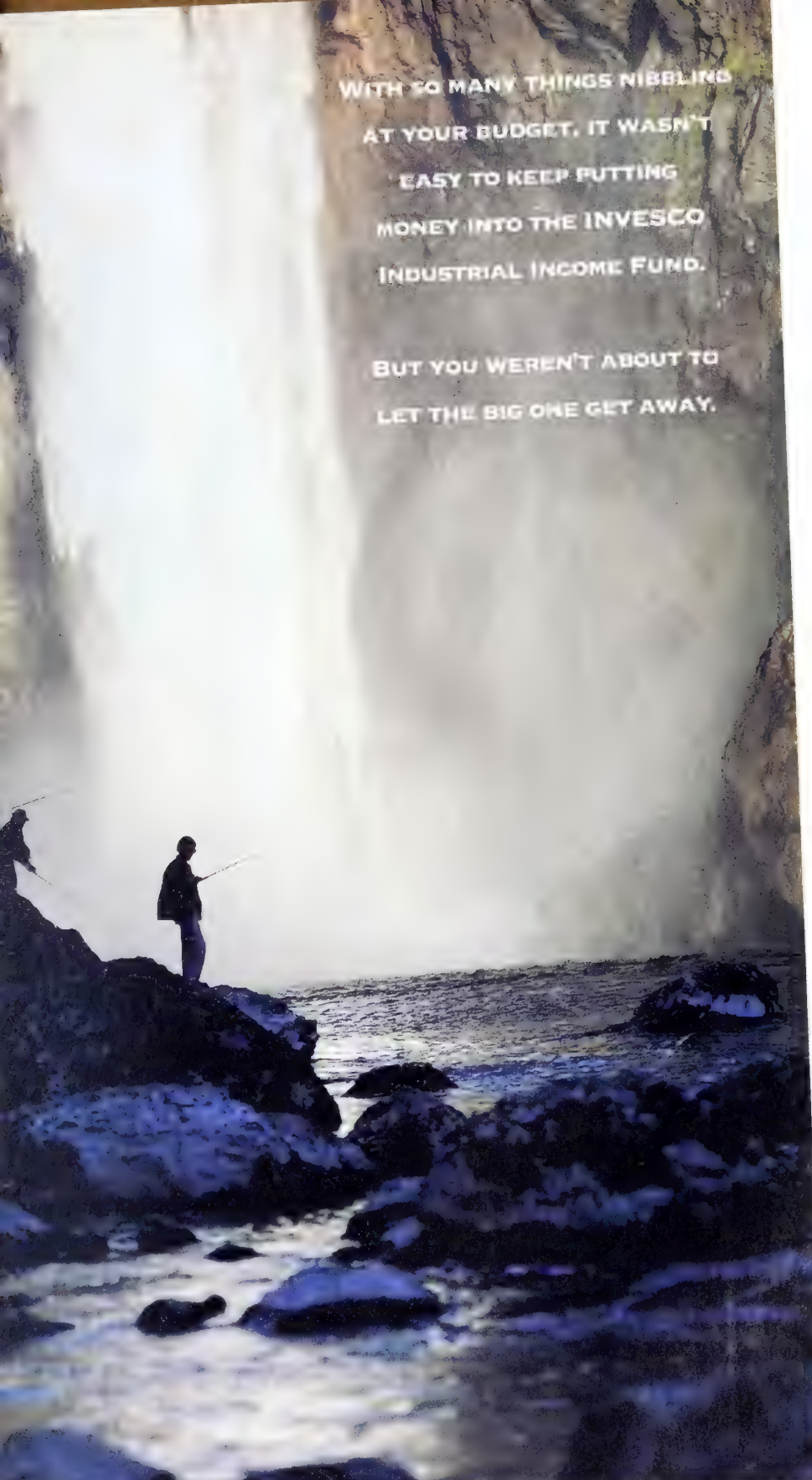
...ITS GDP SHOWS SIGNS OF RECOVERY...



...AND FOREIGN INVESTMENT IS INCREASING

- ▶ Total foreign investment at end of 1993: \$2.7 billion
- ▶ First eight months in 1994: \$1 billion invested in Russian equities
- ▶ Amount invested in 1993 alone: \$1.36 billion
- ▶ Foreigners investing at rate of \$500 million per month

DATA: WORKING CENTER FOR ECONOMIC REFORM, OECD, RUSSIAN ECONOMICS MINISTRY, BW



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FORBES RECOMMENDATION OF INDUSTRIAL INCOME FUND AS A "BEST BUY" BASED ON PROPRIETARY ANALYSIS OF 5-YEAR, RISK ADJUSTED PERFORMANCE AND EXPENSES AS OF 6/30/94.
SMART MONEY'S RECOMMENDATION OF THE FUND AS A "SAFE BET FOR THE '90S" AS OF 9/30/93 BASED ON ITS ASSESSMENT OF STRATEGIES OF THE 26 MUTUAL FUNDS WITH NO LOSSES IN THE PAST DECADE.
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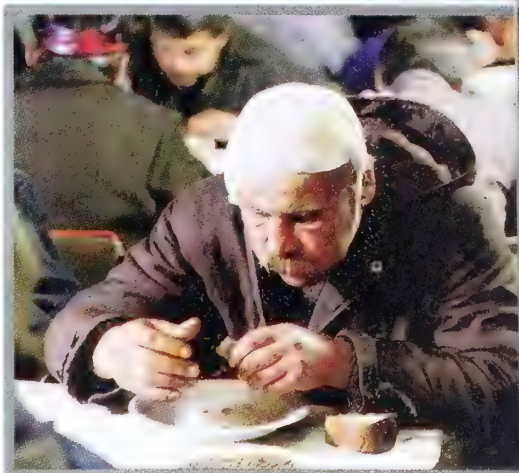
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THE DOWNSIDE

A St. Petersburg prison for gangsters and a Moscow soup kitchen: As the private sector gains momentum, will the crime wave and social turmoil wane?

U.S.-style NASDAQ electronic-trading system that will pump capital into predominately small and midsize new companies.

By yearend, NASDAQ-type trading will begin in Moscow, St. Petersburg, and Ekaterinburg. Later, Novosibirsk in central Siberia and Vladivostok in the Russian Far East will join in. Because of the vast distances between cities, trading via modem is critical, and some 150 companies are likely to go on the system. Russian savers are also being offered other options for their funds, including higher bank interest rates and pension and mutual funds. These instruments could also help attract some of the estimated \$40 billion Russians have stashed away abroad.

PRIVATE SECURITY. But when you talk with Russian entrepreneurs, raising money is usually not at the top of their list of problems. They are more likely to gripe about corrupt bureaucrats, greedy taxmen, and mobsters. Cheating on tax bills that range up to 90% of profits has become obligatory.

So has hiring private bodyguards for protection against mobsters. In the past year, organized criminals have assassinated scores of Russian executives, including 17 bankers. The police are little help, and many former KGB agents have gone into the private security business. Some of these private agencies resemble small military units, and some businesses are said to have responded to threats with "hits" of their own. "Our security force is as strong as the organized criminal groups," says Valery Nezerov, chairman of the Hermes financial group. "Un-

fortunately, we have had to demonstrate our force."

Some executives believe that the crime wave will lose steam as legitimate business gains momentum and society stabilizes. "There's a saying," says Nikolai Shmelev, an economist at the Institute for Europe. "My grandfather was a bandit, my father graduated from high school, and my son went to Harvard."

None of these changes for the better means that doing business in Russia is simple or predictable. The revolution is far from over; millions of people face

to hire anyone who has had more than five minutes' work experience with Aeroflot," says Sergey Grachev, Transaero's marketing director.

So the best option may be for Yeltsin and his cohorts to arrange to let the big state industries die a very gradual death. While the young capitalists will ultimately be hit with high taxes for subsidies and support of retirees, the alternative of sudden wholesale layoffs is much worse.

This transition from old to new could take a decade or more to play out. And plenty of difficulties remain. But the

Transaero's Grachev absolutely refuses "to hire anyone who has had more than five minutes' work experience with Aeroflot"

uncertain prospects. As long as society itself is in turmoil, entering the Russian business world will be an adventure.

Probably the biggest threat to Russia's developing a healthy economy is the huge money-losing former state sector, whose plants still employ more than half of the workforce. There's no way the fledgling private sector can readily absorb the millions of workers who could lose their jobs at weapons factories, white-elephant steel mills, and played-out coal mines. The private-sector hot-shots don't want these people or, indeed, any workers over 40. "We refuse

days when Russians worried that their entire society could collapse have eased. While still wild and chaotic compared with the West, Russia has settled down considerably, giving its people a badly needed whiff of hope. Russian capitalism is definitely taking hold. Now, if only it's given the opportunity to grow, it could help Russia achieve its unrealized potential.

By Peter Galuszka and Patricia Kranz in Moscow and Stanley Reed in New York

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IT'S NOT ONLY ROCK 'N' ROLL

The Rolling Stones' *Voodoo Lounge* tour is a virtual corporation

It is 9:30 a.m., prime sleeping time for rock 'n' rollers, but Michael Cohl is wide awake and well into his first pack of cigarettes. The Canadian concert promoter is padding around his Philadelphia hotel suite shoeless—scanning faxes, taking phone calls, and updating the details of his latest venture: the Rolling Stones' 1994-95 world tour, *Voodoo Lounge*. Mick Jagger and the other Stones will open the first of 12 shows at Veteran's Stadium in 12 days. And in the meantime, Cohl has a business to run: "In our minds, we try to approximate an ordinary go-to-the-office kind of company," he explains. "Only the most callow rock fans would be surprised to learn that the current Stones tour—like the band itself—is fundamentally a business. The wild excesses and seat-of-your-pants planning documented in *Gimme Shelter*, the 1970 film about the band's notori-

ous Altamont concert, is long gone. If one were to remake that film today, it could well be called *Gimme Tax Shelter*.

What's surprising about the *Voodoo Lounge* tour, though, is just how sophisticated an enterprise Cohl and the Stones have assembled. With 250 full-time employees and potential worldwide revenues of \$300 million, the tour operates like a decent-size corporation. But because its staff will disband after it

ends late next year, *Voodoo Lounge* is less a corporation than a virtual corporation. Odd as it may seem, the Stones' tour offers a primer for executives eager to translate this hot management buzzword into reality.

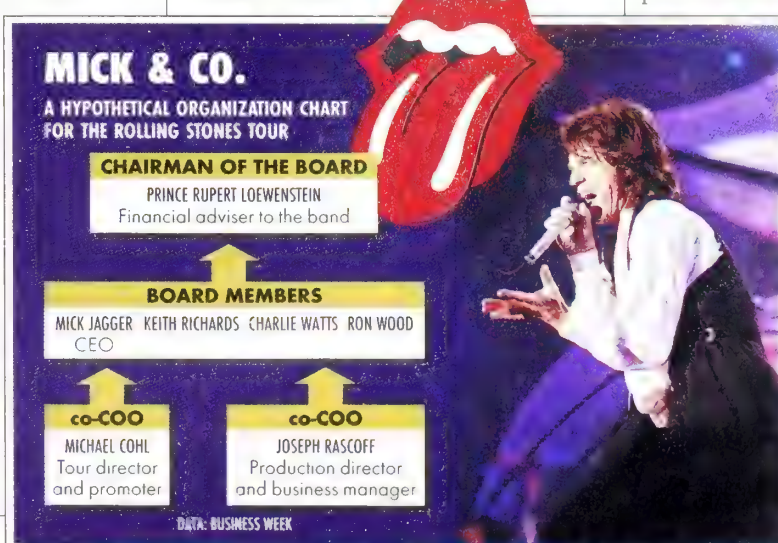
Start with the definition of a virtual corporation: a temporary network of companies assembled to exploit a specific opportunity. No hierarchy, no central office, no organization chart. Cohl, who once owned a strip club in Ottawa before his Toronto-based Concert Productions International, seems only vaguely familiar with the term "virtual corporation." But he has created a perfect one. **SATISFACTION.** Consider his office. Though he is fronting as much as \$140 million to finance *Voodoo Lounge*, Cohl runs the tour with the sort of simplicity Corporate America can only dream of: He travels with just a crate of files, a laptop computer, and a fax machine, which spits out updates on labor costs, travel schedules, and ticket sales.

Here-today, gone-tomorrow organizations are nothing new in the concert business. But *Voodoo Lounge*'s sheer size and complexity sets it apart. The stage, a futuristic monster with a 924-square-foot Sony video screen and a 92-foot-high cobra-shaped lighting tower, requires 56 trucks to haul from city to city. Because the set takes four days to build, three stages leapfrog each other around the U.S. Overseas, the stage will be ferried in two 747 cargo jets and a Russian military cargo plane.

True to "virtual" form, Cohl lets his partners handle much of the logistics. To supply the stage, lighting, sound, and other elements of the show, the Stones have contracted with RZO Productions, a company owned by their longtime business manager, Joseph F. Rascoff. (Rascoff and Cohl both answer to Prince Rupert Loewenstein, the band's financial

adviser in London.) Rascoff, who is a Wharton graduate, employs a team of 200 stagehands, and lighting and sound technicians, plus scores of laborers hired for the individual venues.

Rascoff's team is never in just one place at a time. On Sept. 22, workers were completing the *Voodoo Lounge* stage at Veteran's Stadium. At the same time, a second crew was putting up the steel skeleton of the stage for the show three days later in Columbia,



S.C. And a third crew was prepping the Liberty Bowl in Memphis. With labor costs of up to \$300,000 per city, Rascoff uses a network of portable computers and fax machines to track costs: "We have as sophisticated a budget operation as any company," he says.

Voodoo Lounge's fluid organization allows it to shift gears rapidly. Cohl, for example, scheduled only 42 shows before the tour opened on Aug. 1, partly out of concern that the concert season was glutted with big names such as The Eagles and Barbra Streisand. Once the tour was under way, he felt confident enough to add 23 more shows. With 65 shows in the U.S. and Canada, Cohl predicts the tour will gross 25% more than the Stones' 1989 *Steel Wheels* tour, which earned a then-record \$98 million.

MONEY GAMES. Few things in this venture are more important than money. But seven hours before showtime at Veteran's Stadium, Jake Berry, the tour's production manager, confronts one of them. A roadie has stopped him to report that the Philadelphia fire marshal is threatening to shut down the concert if anyone smokes onstage—including legendary smokers, Keith Richards and Ron Wood. "I'm not going to tell Ronnie and Keith they can't smoke," says Berry, as he rushes to strike a compromise. That evening, as usual, Wood inhales contentedly through the opening number, *Not Fade Away*.

Like everybody on the tour, Berry fervently believes that—despite critics' japes about their advanced age—the Stones are still a good bet to sell out stadiums and make money. As in any virtual corporation, the partners succeed individually by succeeding together. Cohl guarantees the band an estimated \$85 million, both to cover their expenses and as base salary. But after the tour breaks even, he and the Stones stand to make even more money.

Perhaps that's why the Stones, particularly Jagger, immerse themselves in the business of *Voodoo Lounge*. Cohl and Rascoff both consult them on issues such as merchandise and concert dates. The Stones also act as brand managers: "They understand better than anyone what it means to be a Rolling Stone," says Cohl, "and how that name should be used and treated."

When Mick Jagger struts onstage in Philadelphia at 9:45 p.m. that evening, the driving rain and wind of an early season nor'easter barely slow him down. "Welcome to a rather soggy *Voodoo Lounge*," he says jauntily to 50,000 drenched fans, as raindrops course down his memorable mug. For the CEO of a virtual corporation, this is called keeping your end of the bargain.

By Mark Landler in Philadelphia

Marketing

CONSUMER PRODUCTS

ED ARTZT'S ELBOW GREASE HAS P&G SHINING

A brutal streamlining and "value pricing" have boosted profits

When Edwin L. Artzt became chairman of Procter & Gamble Co. five years ago, his main objective was to turn the consumer-products giant into a global company. Yet shortly after he took the reins at P&G, it became clear that Artzt would have to do a lot more than that. Caught in the sway of the growing consumer

and improve customer service by streamlining its once-cumbersome billing and delivery systems. The results have been impressive: In its fiscal year ended June 30, Procter reported its highest profit margins in 21 years. Ever after a \$102 million charge for its highly publicized derivatives disaster, it made a tidy \$2.2 billion. Both in the U.S. and abroad, Procter boosted its market share in most of its businesses while increasing unit volume 5%.

REVISED PLAYBOOK. The changes have not come without pain. Last year, Artzt announced a massive restructuring, cutting 13,000 jobs—12% of the company's employees—and shuttering 30 of P&G's 147 factories. The cutbacks have deeply shaken morale at what had been one of the last U.S. bastions of lifetime employment. And that is something Artzt will have to confront as he tries to get P&G growing again. Sales were essentially flat last year at \$30.3 billion, as divestitures, price cuts, and foreign exchange woes masked the volume gain.

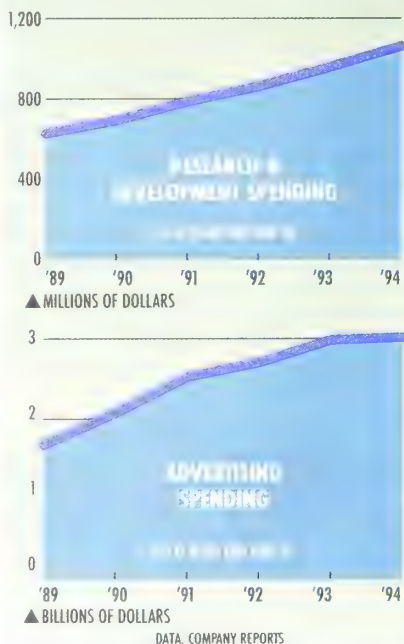
That problem, however, is likely to fall to Artzt's successor. Artzt, 64, may retire as early as next spring. Yet the two front-runners, Executive Vice-President Durk I. Jager, Procter's U.S. chief, and President John E. Pepper, who heads P&G's international operations, are both likely to continue Artzt's value campaign.

As the king of packaged-goods marketing, Cincinnati-based Procter never had to worry much about being the low-cost producer. "Historically, we have been a high-cost operator because we could get the growth we wanted," says one former top P&Ger. The company invented products such as Tide, Crest, and Pampers that it could usually sell at a premium—and mounted massive marketing blitzes to imprint their novelty on consumers. Even now, P&G isn't offering rock-bottom prices. And the company is spending more than ever on research and advertising (charts).

Now, Artzt has added a new page to the P&G playbook. He is slashing at costs, allowing Procter to reduce the premiums at which its goods sell, pres-

INVESTING IN BRANDS

Despite a \$1.5 billion restructuring program to close some 30 plants and eliminate about 13,000 jobs, P&G is spending more than ever on research and marketing



demand for value, P&G—known more for its premium brands at premium prices—suddenly found itself out of step. Artzt's answer was simple: Change the way P&G does business. Says Artzt: "We have to become single-minded in our quest to deliver better value."

Against great odds, P&G has. Under Artzt, the company has moved aggressively to cut costs, keep prices down,



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asuring both private-label rivals and national-brand purveyors such as Lever Brothers Co. and Colgate-Palmolive Co. This strategy is most important in the U.S., where Procter generates 69% of its earnings. "They've learned low-cost production and clear-cut product superiority are not mutually exclusive," says one former vice-president.

P&G's big move in the U.S., starting back in 1991, was to slash the promotions it offered to trade customers. These discounts corroded the loyalty of shoppers to P&G brands because they

Yet value pricing has worked. For example, Procter cut the list price of liquid laundry detergents two times—first by 9% in late 1992, when it introduced concentrated liquids, and then again by 15% in the summer of 1993. Along with new products, that has bolstered P&G's share from about 41% to 47%, according to Information Resources Inc.

The value credo has impelled P&G to simplify its vast array of products. Since 1991, the company has eliminated almost a quarter of the different sizes, flavors, and other varieties of its brands. Un-

shipped on a single truck. Many companies are working on computer-to-computer reordering and other such systems, notes Donald D. Bennett, president of Richfood Holdings Inc., a \$1.5 billion wholesaler in Richmond, Va. "P&G got there quicker than anybody."

DIAPER RIVAL Yet some analysts, such as Lynne R. Hyman of CS First Boston, wonder if P&G hasn't sacrificed product innovation in its quest for value. Defenders say P&G has had some winners, such as the papermaking technology it used to create a more absorbent Bounty paper towel. But in the important U.S. diaper business, Procter is still struggling to catch up after falling behind rival Kimberly-Clark Corp.

With more than half of P&G's sales now coming from abroad and with growth prospects strongest there, Artzt is more intent than ever on building a global presence

bent Bounty paper towel. But in the important U.S. diaper business, Procter is still struggling to catch up after falling behind rival Kimberly-Clark Corp.

With more than half of its sales now coming from abroad and the best growth prospects there, P&G is looking to globalize more than ever. Says one retired executive: "If they put a bust of Artzt in the west wing [of P&G headquarters], I would say: 'This SOB made us a truly global company.'"

That doesn't necessarily favor Pepper as the man to succeed Artzt, since Jager, too, has won kudos for his foreign successes. Pepper, a congenial executive who is highly popular with the troops, would be the one to ease staff discontent. That's important, since the exodus from its restructuring has some outsiders wondering if P&G could find itself short of talented managers down the road.

But Jager, a hard-nosed, Dutch-born executive, can make a strong claim, especially because of the success of value pricing in the U.S. And he has the stomach for tough decisions, such as dumping the company's Citrus Hill orange juice, a longtime loser.

Not everyone has ruled out the possibility that Artzt could find a way to stay on. But whoever is running P&G next spring, you can expect they'll be as value-conscious as the consumers they count on to buy their products.

By Zachary Schiller in Cincinnati



led to yo-yo shelf prices—Tide at \$1.99 one week and \$2.99 the next. They also produced enormous costs, whether it was a wholesaler pocketing much of the discount, big swings in production as specials came and went, or vast overhead in keeping track of all the deals.

Over the past three years, P&G has reduced its list prices by 12% to 24% on nearly all of its U.S. brands, most of that by cutting the level of trade promotion. At first, "value pricing," as P&G calls it, hurt its sales. Rivals tried to take advantage with their own deals, and many customers were upset because it hurt their profits. Even now, Procter's share in many categories isn't as high as it was several years ago.

productive coupon promotions have been slashed. Brands, such as Clarion cosmetics and White Cloud toilet tissue, either have been given the heave-ho or have been combined with stronger monikers.

Now, P&G is moving forward with crucial changes in logistics and customer relations. After years of restructuring its U.S. sales force, early this year it reorganized so that it now relies largely on customer-based teams, which offer support to customers with data analysis, finance, and other functions. And on Oct. 1, the company is beginning "streamlined logistics," which will let customers order almost all of Procter's products using one invoice and one set of payment terms and have the entire order

FREE REPORTS FROM A SELECT GROUP OF AMERICA'S FASTEST-GROWING COMPANIES

The exceptional companies listed alphabetically below want you to know more about them. Simply complete the attached coupon for **free** copies of their annual reports. Nearly every actively traded company was screened, using data provided by Standard & Poor's Compustat Services, to determine the top growth companies in America invited to appear.

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INSIDE FIDELITY

HOW THE FUND GIANT'S STOCK-PICKING MACHINE WORKS

Managing the world's largest mutual fund affords special privileges. After taking over Fidelity Investments' then \$22 billion Magellan fund in 1992, Jeffrey N. Vinik visited Motorola Inc. In a whirlwind day, he had private meetings with Motorola's seven top executives, including then Chief Executive George M.C. Fisher, and grilled them on their business. On the plane coming back from Chicago, Vinik worked up earnings forecasts on a yellow legal

pad—he doesn't know how to use computerized spreadsheets—and came to a startling conclusion: "I realized they were going to earn nearly double what [Wall Street] analysts were projecting."

How did he figure that? Both Vinik and a Motorola spokeswoman swear that no information was revealed beyond what is normally available to all investors. But Vinik was convinced that Wall Street was sharply underestimating demand for Motorola's semiconductors,

both from foreign markets and from the cellular phone industry. Within four months, by March 1993, Fidelity had bought 7.4 million Motorola shares for about \$250 million. Vinik was right on the money. The stock has more than tripled, producing huge gains, not only for Magellan but for dozens of other Fidelity funds whose managers followed Vinik's lead.

His savvy play on Motorola illustrates a lot about why Fidelity's equity mutual



THE FIDELITY METHOD

KNOW YOUR COMPANIES INSIDE OUT

Jeffrey Vinik follows stocks for the \$37 billion Magellan fund in part by grilling the CEOs of 200 of the 550 companies in his portfolio. To track the remaining stocks, he leans heavily on Fidelity's research staff. But his strategy helps guide many of Fidelity funds.

LOOK FOR IMPROVING FUNDAMENTALS

Beth Terrana has outperformed the market on each of her three portfolio assignments. Now heading the \$17 billion Fidelity Fund, she invests heavily in turnaround stocks. One favorite is Scott Paper, whose shares are up some 15% over the past two months.

s deliver amazingly strong returns dominate the mutual-fund industry: npower, hard work, willingness to lence conventional wisdom, and the ty to use its huge size to ferret out able information. Indeed, no other company approaches the Boston-d giant when it comes to investing public's money in stocks. The flag-Magellan fund, now with \$37 billion ssets, was the nation's top-perform-fund in the 1980s. Even with its gar-cuan size, Magellan manages utrun hundreds of other funds a similar investment goals.

IN FOUR. But Fidelity's suc- es go far beyond Magellan. The age cumulative return for its rsified U.S. equity funds over past 10 years is 407.7%. Ex- ing Magellan, the figure only os to 403.5%, according to ningstar Inc., which tracks performance. Among the comes managing the most equity- l assets, the closest to Fidel- s Twentieth Century Investors, a 375.7%. Although Fidelity's s have trailed a few rivals in past year, they have a com- ding lead over the most re- three- and five-year periods.

Combine those bountiful returns with the fund industry's most sophisticated marketing operation, and it's easy to understand why Fidelity's stock funds now command 17.5% of all equity-fund assets, according to Strategic Insight Inc., a fund-industry consultant. Even more impressive is that in the first eight months of 1994, a time of jittery markets, Fidelity captured nearly one of every four dollars in net cash flow into all equity funds.

By almost every measure, Fidelity's stock-picking machine is the most sophisticated and successful that Wall Street has ever seen. It's built around the guiding principles set down by Peter Lynch, the now retired superstar portfolio manager of the Magellan fund. Lynch's investment philosophy is to immerse himself in a company's business and try to spot the significant changes ahead of the crowd. Lynch disdains trying to time turns in the stock market or the economy; he feels funds should almost always be fully invested.

Fidelity's stock-picking machine is fueled by unparalleled entrée to corporate executives, state-of-the-art investment technology, the best Wall Street research—produced by Fidelity's huge flow of brokerage commissions—and an unusual corporate culture that motivates its talented portfolio managers to excel far beyond most of their peers.

For the past decade, mutual-fund pundits have warned investors that Fidelity's winning streak could not last, because its funds were becoming too large to outperform smaller, nimbler competitors. The more money under management, the argument goes, the

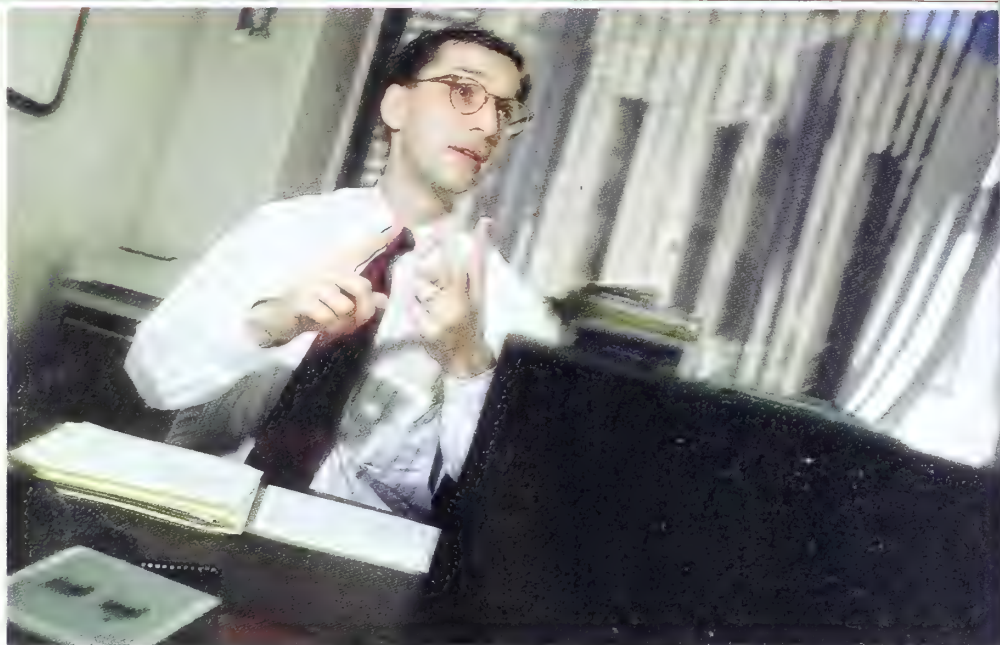
TOP OF THE HEAP

Fund group	Cumulative average total return*			
	10-year	5-year	3-year	1-year
FIDELITY	407.7%	89.2%	50.6%	7.7%
TWENTIETH CENTURY	375.7	83.5	40.4	2.2
PUTNAM	308.1	73.1	44.3	5.9
AMERICAN	300.0	63.0	40.3	6.0
IDS	276.8	70.4	37.6	4.8
FRANKLIN/TEMPLETON	255.4	57.0	37.8	9.2
T. ROWE PRICE	244.5	63.7	46.4	8.7
VANGUARD	243.3	56.9	36.9	5.9
MERRILL LYNCH	234.0	52.9	37.8	6.1
DEAN WITTER	214.7	54.2	27.7	0.5

Largest equity fund managers. Averages are U.S. diversified funds; exclude index funds
*Appreciation plus reinvestment of dividends and capital gains DATA: MORNINGSTAR INC.

LOOK FOR OPPORTUNITIES ABROAD

Brian Posner is the brains behind Fidelity's huge stake in British Petroleum. With 24% of his \$7.4 billion Equity-Income II Fund invested overseas, he wakes at 5:30 a.m. each day to check foreign markets on his home computer. He's a big fan of using technology to harness the vast amount of information Fidelity managers have at their disposal.



harder it is, percentage-wise, to produce large returns.

Academics, further, argue that investment returns "regress to the mean"—or, in other words, all eventually just become average. But Charles A. Trzcinka, a finance professor at the State University of New York at Buffalo and a student of mutual funds, has forecast Magellan's regression for five years and it hasn't happened yet. "It's either tremendous luck or enormous management skill," he says. Whatever the case, Fidelity's equity operation continues to defy the odds.

BIG RISKS. Academics aside, the greater risk to Fidelity's primacy is a prolonged bear market. Aided by its aggressive, fully-invested strategy, Fidelity capitalized on the strong bull market to widen its lead over other equity funds. Whether Fidelity would do so well during a prolonged bear market is far from clear, for Fidelity has been taking some big risks that are not apparent to most of its investors—or even to Wall Street.

Much of its success has come from making large, concentrated bets. Fidelity now has 25% of its \$140 billion in equity assets in just 30 stocks. Magellan, for instance, has 28.5% of its assets in technology stocks. During a three-day rout in tech stocks that began on Aug. 30, the fund lost some \$650 million. The incident suggests how a severe downturn in technology could hurt not just Magellan, but Fidelity as a whole. All but a handful of Fidelity's largest growth funds have stakes of 10% or more in technology.

These concentrations could prove difficult to unload if the stocks or indus-

tries stumbled badly and investors wanted out. "If there were ever liquidity problems, there would obviously be price concessions" that would hurt the performance of their funds, says Mark Rowland of Rowland & Co., an Atlanta money manager. William J. Hayes, chief operating officer of Fidelity's equity funds says that the large concentrations will not create a liquidity problem. "It's not going to happen." The reason: "There are so many different [investment] disciplines here that people are always buying and selling at different times."

While industry concentration does pose some additional risk, Fidelity has been trying to offset that risk by diversifying into foreign markets. Many of its growth funds regularly invest a portion of their assets abroad. So far, the move has produced some snappy returns. The company has 50 investment professionals in London, Tokyo and Hong Kong.

That commitment of resources is typical of Fidelity. Indeed, access to information is perhaps the most important component of Fidelity's edge. How many fund managers could command the time that Vinik got at Motorola? Or how many fund complexes get visits from top executives of as many as 20 companies each day?

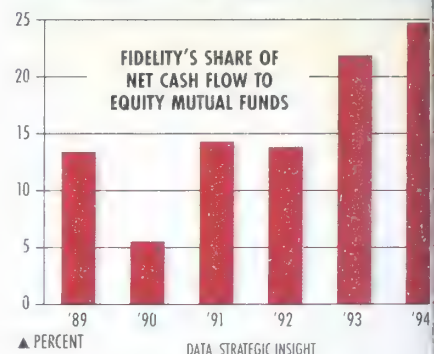
Fidelity's in-person sessions with top corporate executives can often prove decisive in making investment decisions. Eastman Kodak Co. is a good example. Fidelity managers had numerous meetings with its executives, especially then Chairman Kay Whitmore. During the past two years, Fidelity managers accu-

mulated the stock because it looked cheap: Kodak had a strong cash flow and dominant share in its markets. At one point, Fidelity funds owned 8% of the company.

By 1993, as Kodak struggled with a restructuring, some Fidelity managers became skeptical of Whitmore's management style. They began asking more pointed questions and telling Whitmore what they thought should be done, such as sticking to its imaging business and shedding unrelated units. "They tear apart management's way of thinking," says Timothy P. Cost, Kodak's former investor relations director, who sat in on most of the meetings. Finally, convinced Whitmore wouldn't be able to turn Kodak around, Fidelity dumped its entire holding—at a profit. "He always disappointed us," says Beth F. Terrana, portfolio manager of the Fidelity Fund.

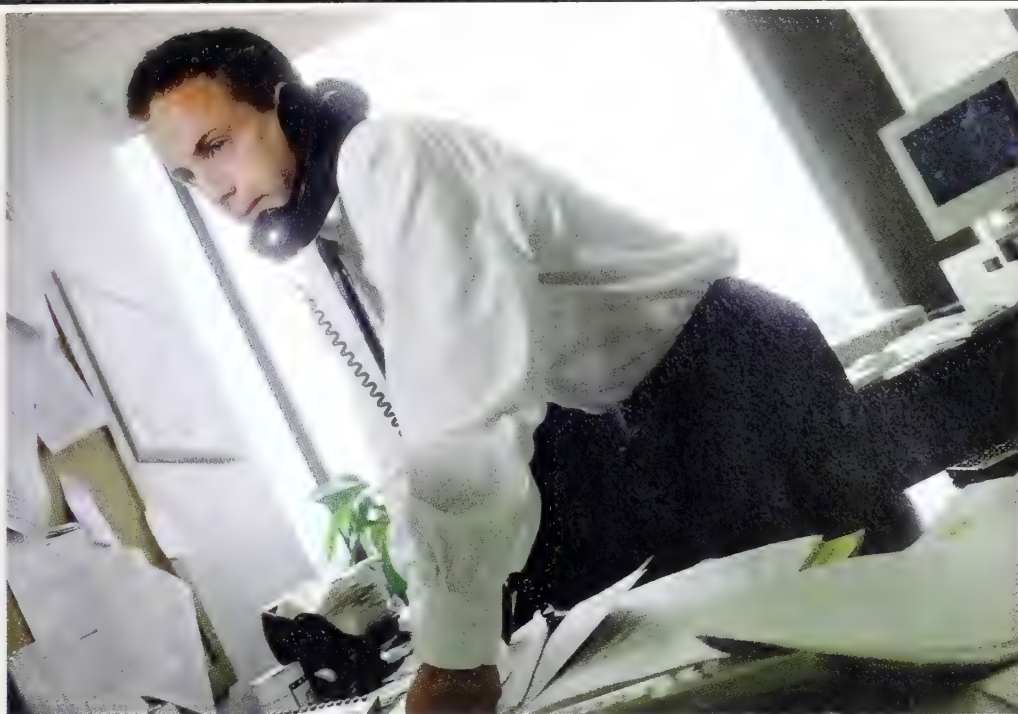
Another meeting with a company's

AS INVESTORS CHOOSE FIDELITY'S EQUITY FUND



AMWORK BEATS PERIENCE

Michael Gordon earned a degree in English from MIT in 1987, started as a tech analyst, and has become a star. In January, 1993, he took over the Blue Chip Growth Fund and has since racked up a 34% return. "What I lack in experience is made up for by working next to the best investors in the industry."



management led to one of 1994's most successful investments: American Cyanamid Co. Most Wall Street analysts turned their noses up at the restructuring plan that CEO Albert J. Costello laid out earlier this year. But Charles A. Mangum, who runs the Fidelity Select Health Care fund, was intrigued enough to attend a Mar. 15 investors' lunch with Cyanamid management, hosted by a brokerage firm. "I was impressed by [Costello's] aggressiveness," Mangum says, speaking of Costello's plan to sell certain units and focus the business on others. His assessment: "The company was at least 60% undervalued."

Back at Fidelity the next day, he dictated the trading desk to buy Cyanamid for his own fund. And he shared the epiphany with other managers. "I went from office to office, pitching the stock to everyone I could find." By mid-

May, Fidelity funds owned 8 million shares at an estimated cost of \$46 a share. In early August, American Home Products Corp. saw value in Cyanamid, too. It agreed to pay \$101 a share for the company—a 120% gain for Fidelity shareholders.

SHARING IDEAS. Although Fidelity managers often buy in concert, they also tend to have different views on when to sell. Consider Entergy Corp., a natural-gas company that was one of Fidelity's major holdings in late 1993. Terrana and several other managers unloaded the stock when it peaked at \$40 a share. But Vinik thought the boom in gas stocks would continue—and watched as the stock tumbled to about \$30 before throwing in the towel. "Their earnings didn't come through like I thought," Vinik says. "I held on too long."

Fidelity managers are required to share ideas and information. The rationale: if everyone discloses his best ideas, it will help all the funds excel. Every morning, for instance, they get a list of all stocks bought and sold by the funds the prior day: On average, Fidelity trades \$1 billion worth of stock in 1,000 companies every day. They also get summaries of every contact between a Fidelity staffer and a corporate manager, whether it was brief phone call or an all-day visit to a company's headquarters. "It's easy to suffer from information overload here," says Brian S. Posner, who runs the \$7.4 billion Fidelity Equity-Income II Fund. "The challenge is to stay organized."

Sharing ideas also significantly eases the burden of managing Magellan and some of the other multibillion-dollar

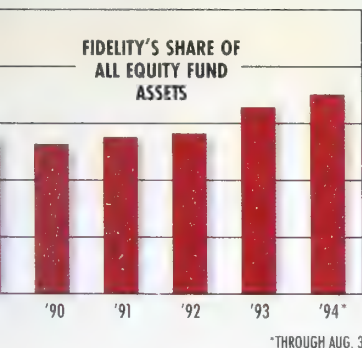
funds. Vinik says he closely follows 200 of the 550 stocks in Magellan. He relies on other Fidelity staffers to help keep track of the rest. Close cooperation between fund managers is also encouraged by the compensation system. Managers' income depends not only on what their own fund achieves but also on how other Fidelity funds do against the competition. And they are judged on how many winning ideas they contribute to the company. Managers can earn from \$100,000 to \$1 million a year, depending on the size of the fund and its returns.

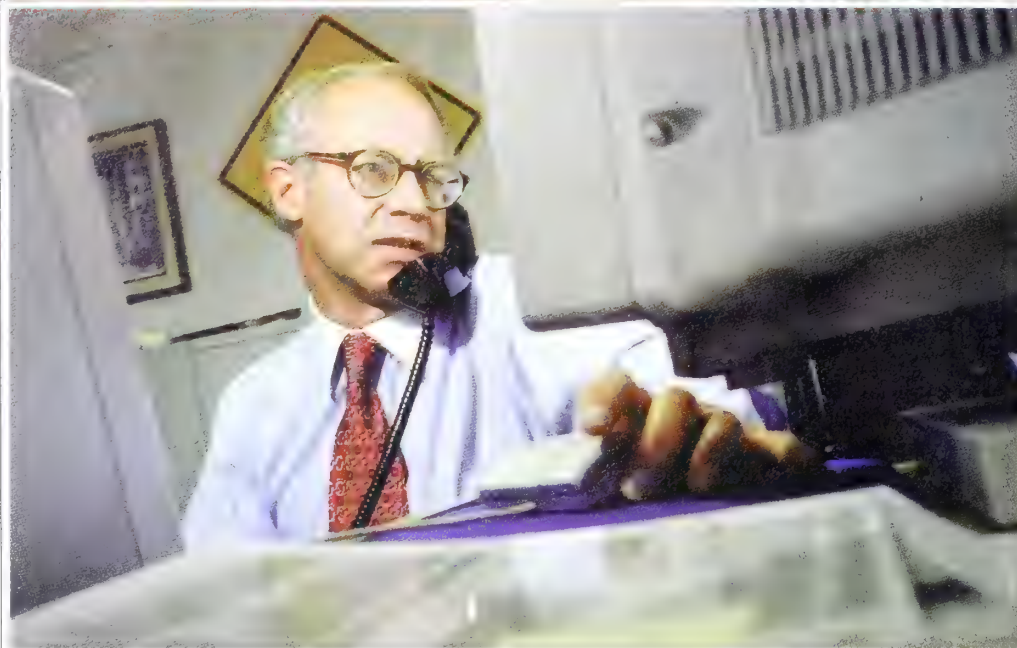
To encourage informal communications, equity managers and analysts are packed in small offices on two leased floors of a downtown Boston bank. Their tiny quarters serve as a clearinghouse for investment ideas, and most are bursting with reams of financial documents. They typically work 12-hour days, often weekends, and travel frequently. "We learn here through osmosis," says Michael Gordon, who runs the \$1.5 billion Blue Chip Growth Fund.

It's a high-pressure atmosphere, one capable of turning smart college graduates and MBAs into big-time money managers in just a few years—or sending them packing. Of some 700 applicants yearly, Fidelity hires only four or five. They're assigned to follow one industry, work closely with an experienced manager, and meet for an hour once a month with Peter Lynch, who now serves as a mentor. Analysts who make the grade are usually allowed to run an industry-specific sector fund within two years.

Because they get some of the best training in the investment business, Fidelity managers are actively courted by

ITS DOMINANCE OF THE FIELD GROWS





FLEXIBILITY IS A KEY TO SUCCESSFUL INVESTING

George Vanderheiden keeps a low profile, but his returns are high. He is known for his ability to dissect financial statements and spot subtle shifts in the stock market. By the frenetic standard at Fidelity, he is a patient investor. And he is a mentor to many young Fidelity analysts.

competitors. Surprisingly few leave. Terrana says that even huge paychecks promised by hedge funds, which can pay much more than mutual funds, aren't sufficient incentive. "I get calls from headhunters all the time, but could I really be as successful outside Fidelity?" she says.

FLYING DATA. Good question. For one thing, few competitors can offer Fidelity's technological and logistical support. All the managers and analysts have Sun Microsystems Inc. workstations on their desks that supply not only all of Fidelity's internal research but virtually all available Wall Street research and almost every electronic market-monitoring system. Fidelity's programmers are constantly coming up with ways to organize and analyze information. Their latest invention is proprietary software that can locate financial statements from any Securities & Exchange Commission filing and dump it in an electronic spreadsheet in a matter of seconds—even on an airplane.

Fidelity managers weighing outside offers also have to consider doing without other benefits of the fund group's enormous clout on Wall Street. With \$300 million a year in commissions to spend, Fidelity is Wall Street's No. 1 brokerage customer. That means it not only gets the best research but, as they say on the Street, tends to get the first call. There are other perks. When Duracell Inter-

national Inc. went public in a heavily oversubscribed offering in 1991, Fidelity received 10% of the shares it wanted, while other investors got no more than 5%. Duracell's price rocketed 30% after the offering.

Fidelity can also demand that brokers put up their own money to accommodate its trading. That could mean buying a block of stock that Fidelity wants to sell even when there are no other buyers. "Brokers know we demand loyalty," says trader James J. Altoonian. "They usually go along." While not unusual for large investors, it's another way Fidelity gets an edge over smaller fund companies.

Some Wall Streeters claim that Fidelity uses its size and concerted buying

strategy to push up the prices of stock it thinks have potential. "If Fidelity like a stock, it could become a self-fulfilling prophecy," says one prominent Boston money manager. "A lot of their returns have been created by their own buying," adds Atlanta money manager Marl Rowland. However, G. Kenneth Heebner, portfolio manager of CGM mutual funds, says Fidelity's power to push up stock prices is limited. "Sure they can do it, but once they've stopped buying, the market can just as quickly push it back down."

Whatever the case, size can have its drawbacks, too. When Fidelity managers fall in love with a stock, they can't buy indiscriminately. The 11 stock traders who execute orders for the managers

must accumulate the huge positions Fidelity funds demand without tipping off the market and running up the stock. Says David M. Laliberte, head trader for Magellan: "Sometimes it's hard being patient when there aren't any sellers."

Of course, Fidelity is so large a manager that it can sometimes fill an order by buying stock from sister funds. George A. Vanderheiden, who runs three growth-stock funds totaling about \$9 billion, had his eye on Cherry Corp., the Chicago auto parts supplier. But the shares were thinly traded, and he figured buying all he wanted on the open market might push the price too high. So he waited until another fund wanted to sell

FIDELITY'S BEST PERFORMERS

U.S. diversified equity funds with 10-year records	Average annual total return*			
	10-year	5-year	3-year	1-year
FIDELITY CONTRAFUND	19.0%	18.7%	15.8%	1.7%
FIDELITY MAGELLAN	18.7	13.0	13.3	2.5
FIDELITY DESTINY I	18.2	15.7	17.9	15.9
FIDELITY GROWTH COMPANY	17.0	14.9	10.7	4.9
FIDELITY RETIREMENT GROWTH	16.2	13.6	17.5	10.2
FIDELITY PURITAN	15.0	11.3	15.6	8.7
FIDELITY	14.3	9.7	11.0	8.4
FIDELITY TREND	14.2	10.2	14.1	3.3
FIDELITY VALUE	14.2	11.4	18.7	16.0
FIDELITY EQUITY-INCOME	14.0	9.4	15.1	8.5
U.S. DIVERSIFIED EQUITY FUNDS	12.8	9.4	10.3	4.4
STANDARD & POOR'S 500	14.9	9.6	9.5	5.5

* Appreciation plus reinvestment of dividends and capital gains, ended Aug. 31, 1994

DATA: MORNINGSTAR INC.

**“SINCE TODAY’S
BUSINESS BUZZWORD
IS ‘GLOBAL,’
IT’S A GOOD THING
WE ALREADY ARE.”**

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Argentina, Aruba (1995), Australia, Austria, Barbados, Bermuda, Canada, Costa Rica (1996), Egypt,
Germany, Greece, Hong Kong, Hungary, Indonesia (1999), Japan, Jordan, Malaysia (1996), Mexico,
The Netherlands, Pakistan, Poland, Puerto Rico (1995), Saudi Arabia, Singapore (1995), Thailand,
United Arab Emirates, United Kingdom, United States of America.

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Warner Bros. Studio Stores are opening about as fast as a...beep beep...*Roadrunner*, and a big part of their business is original artwork, or cels, from Warner Bros. cartoons.

"No two production cels are alike, yet each one has to be available in all of our 100 stores, simultaneously," says Karine Joret, Vice President, Worldwide Marketing.

What Joret needed was a client/server system that could 1) display cels in perfect detail, 2) be easy enough for any user, 3) make it impossible for two customers to order the same cel and 4) integrate smoothly with their existing point-of-sale system.

"We also needed a vendor who really knew retailing and could do the entire job, at our speed. It was IBM."

What IBM created is an OS/2®-based multimedia system with touch-screen PC clients in stores and a server in Burbank, all tied in to a RISC-based network for

point-of-sale. IBM wrote the application software and helped build facilities for digitizing images at the Warner Bros. Studios.

"Now," says Joret, "instead of flipping through photocopies, customers browse on a

screen, and the instant a cel is bought it's pulled from the system, even as other customers browse in other stores. It's exactly what we asked for.

"As upcoming animated films, such as the *Roadrunner*'s 'Chariots of Fur,' create more demand for our products, our business grows and our needs change. IBM is always right there with us; I can't tell you how helpful that is."

It's another side to client/server IBM takes seriously: that you're the client, and we're the server. Call us and you'll see. That's all folks.

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“What you
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client/server
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who’s
animated.”



Karine Joret
Vice President
Worldwide Marketing

Cherry and then bought the shares through an intercompany transaction—which also saves on commissions. Fidelity won't disclose details of internal trades, but they are regularly monitored by the SEC.

For all of Fidelity's investment savvy, technological prowess, and financial clout, the Fidelity machine still depends on the willingness of investors to entrust their savings to them. So far, they've proved remarkably loyal, even when times have been tough. Money continued to pour in after the 1987 stock market crash and again during the 1990 bear market.

Fidelity's ability to continually attract new investors is sometimes attributed not to its stock-picking skills but to smart marketing. Its estimated \$80 mil-

lion advertising budget—the largest in the industry—has been deftly used to push the hottest funds. But in the last year especially, as the stock market has cooled, Fidelity's marketing effort has shifted, too. Now, the company is emphasizing investing for education and for retirement—and the pitch seems to be working.

LONG HAUL Even in a prolonged market slump, Fidelity has much in its favor. Some 41% of Fidelity's \$272 billion in mutual-fund assets is in 401(k) plans and other retirement accounts, up from just 28% in 1989. This steady business is growing at 33% a year, vs. 23% for the entire fund operation. Although Fidelity funds are mainly sold directly to investors by phone and investor centers, the company's Fidelity Advisor funds

are now sold by banks, brokerage firms and financial planners. Investors who buy funds through sales forces are much less likely to move money around than those who buy directly. "Fidelity's very well-positioned for the market we have now," says fund consultant Avi Naei of Strategic Insight.

Peter Lynch argues that Fidelity's growth potential remains enormous, even if its funds do run into some heavy weather occasionally. History shows that the longer your investment horizon, the more compelling is the case for owning stocks. As long as that continues to be true, Fidelity's wondrous stock-picking machine seems likely to approach the long-elusive goal of perpetual motion.

By Geoffrey Smith in Boston

IN BONDS, FIDELITY ISN'T SO FABULOUS

Fidelity Investments blows everyone else away with its equity funds. But when it comes to its fixed-income funds, its record is, well, just pretty good. One reason is that for a long time Fidelity didn't take bond funds seriously. It has just \$31.3 billion in fixed-income assets under management, which trails such managers as Franklin Resources Inc. and Vanguard Group. When those companies were building bond funds during the 1980s, Fidelity focused on stocks.

Over the past five years, Fidelity has been playing catch-up. It launched 29 new funds, boosted staff by a third, to 81, and hired 15 specialists in foreign bonds. The fixed-income managers work much like the equity folks, with an organization and a compensation plan that demands teamwork.

A STANDOUT. Their record so far? Not bad, but still not up to the high standards that have been set by Fidelity's equity funds. In most categories, Fidelity's bond funds beat the fund industry average over the 10-, 5-, 3-, and 1-year periods (table). Thomas J. Steffanci, a PhD in economics who joined Fidelity in 1990 and heads the fixed-income group, says its bond funds have performed in the second quartile of all bond funds. His goal: the top 25%, like Fidelity's equity funds.

The standout is Fidelity Capital & Income, the nation's largest junk-bond fund. This powerhouse, with \$2.6 billion in



BOND CHIEF STEFFANCI: PLAYING CATCH-UP

assets, specializes in buying up debt in bankrupt companies and taking an active role in turning them around. Its most recent success was R.H. Macy & Co., in which it owned a big chunk of subordinated debt. In July, fund manager David Breazzano helped push the bankrupt retailer into accepting a

merger from Federated Department Stores Inc., producing a 30% return on his investment.

Taken together, Fidelity's three junk-bond funds have topped the average by at least three percentage points over the past 3-, 5-, and 10-year periods. That's no surprise, since junk-bond investing is a first cousin to equity investing. To do it right, portfolio managers have to know how to tear apart a financial statement and question a CEO.

BAD SHOW. Most of Fidelity's other bond funds have done reasonably well—during a year that has been very tough for all bond funds. Fidelity Intermediate Bond, the largest investment-grade bond fund, is down 2%, but it's still faring better than nearly 90% of its competitors. Yet Fidelity New Markets Income Fund, which invests in

emerging markets debt, is down 14%. Fidelity Spartan Long-Term Government Bond has a total return of -11.6% over the past 12 months. While all long-term bond funds have suffered, that's still one of the worst showings. "This year has been a humbling experience" for Fidelity's bond managers, says Eric Kobren, publisher of *Fidelity Insight*, which tracks Fidelity's funds.

Humbling is not a common word in Fidelity's lexicon. You can bet Fidelity will do everything possible to avoid being humbled again.

By Geoffrey Smith in Boston

THE BOND FUNDS: JUST PRETTY GOOD

Type of bond fund	Average annual total return*			
	10-year	5-year	3-year	1-year
HIGH-YIELD CORPORATE				
FIDELITY AVERAGE	13.1%	13.7%	16.9%	3.8%
FUND INDUSTRY AVERAGE	10.8	9.6	13.4	2.3
INVESTMENT GRADE CORPORATE				
FIDELITY AVERAGE	10.3	8.3	7.7	-1.5
FUND INDUSTRY AVERAGE	10.3	7.9	7.1	-2.1
GOVERNMENT				
FIDELITY AVERAGE	10.1	7.1	5.8	-1.9
FUND INDUSTRY AVERAGE	9.3	7.4	5.9	-2.2
MUNICIPAL				
FIDELITY AVERAGE	9.4	7.7	7.3	-0.7
FUND INDUSTRY AVERAGE	9.2	7.5	7.2	-0.7

*Appreciation plus reinvestment of dividends and capital gains for periods ended Aug. 31, 1994

DATA: MORNINGSTAR INC.



William Tell Monument, Atdorf



Statue of Liberty, New York

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A black and white photograph of a dog, likely a Border Collie, sitting and looking directly at the camera with its mouth open, showing its teeth. The word "dog" is printed vertically on the left side of the image.

More people choose cotton
over any other fabric.

* 1994 EPA fuel economy: 20 city mpg. Actual mileage may vary. ** 1994 American Honda Motor Co., Inc.

More people choose ice cream
over any other treat.



More people choose the Accord
over any other car.*



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here is making a statement. One which
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A Car Ahead

REVERSALS OF FORTUNE FOR MUTUAL FUNDS

Many went from darlings to losers and vice versa, making the third quarter a "very dramatic time"

All that glittered in 1994's third quarter was not gold. Mutual funds that focused on emerging Latin American markets crowded the list of top performers, joined by a number of domestic technology and health-care portfolios, as well as funds targeting China and Southeast Asia. But the most dazzling performance did come from a pure play on the yellow metal. After ending 1994's first half down 15.30%, the \$137 million Lexington Strategic Investments Fund, which focuses on South African gold shares, snapped out of its lethargy to tear up the charts, ending the quarter with a 43.55% gain.

That turnaround is just one example of the abrupt reversals of fortune many funds experienced in 1994's third quarter. Many of the quarter's big winners,

such as the Latin America funds, were investment pariahs earlier in the year, when their thinly traded, frothy native stock markets suffered sizable corrections. And many of the quarter's losers, such as funds concentrating on Japanese stocks and real estate, were the first half's darlings. Case in point: Capstone Nikko Japan. It wowed investors with a first-half total return of 27.69%, making it the second-best-performing fund. This quarter, it had the dubious distinction of being the fourth-worst performer, falling almost 7%. "The second to third quarter was a very dramatic time," says John Rekenenthaler, *Morningstar Mutual Funds*' editor. "It's a perfect reminder of how easy it is to lose money by selling funds that have gone down and buying funds that have gone up."

Many equity funds, however, had happier tales to tell of how they did this summer. None of the 19 equity-fund groups tracked by mutual-fund data company Morningstar Inc. turned in a negative return, in stark contrast with the parade of negative signs preceding the same fund categories in the first half. Equity funds were up an average of 5.2%, a decent return and a big improvement from their -3.38% return as of June 30. That beat the Standard Poor's 500-stock index average, up 4.19% as of Sept. 26.

If equities emerged from the summer somewhat refreshed, bond funds were still stressed out from the deleterious effect of rising interest rates. While improving since the first half, many bond funds had puny returns. Taxable fixed-

THE BEST RETURNS

APPRECIATION
PLUS REINVESTED
DIVIDENDS AND
CAPITAL GAINS
BEFORE TAXES

JUNE 30-SEPT. 26, 1994

LEXINGTON STRATEGIC INVESTMENTS	43.55%	FIDELITY SEL. SOFTWARE & COMPUTER	19.86%
BT INVMT. LATIN AMERICAN EQUITY	34.52	MORGAN STANLEY INSTL EMERG. MKTS.	19.68
HERCULES LATIN AMERICA VALUE	32.17	FIRST AMERICAN TECHNOLOGY A	19.60
GOVETT LATIN AMERICA	31.21	FIDELITY SELECT PRECIOUS METALS & MIN.	19.46
G.T. LATIN AMERICA GROWTH A	30.60	MONTGOMERY INSTL EMERGING MARKETS	19.33
FIDELITY LATIN AMERICA	29.10	PBHG EMERGING GROWTH	19.09
SEVEN SEAS EMERGING MARKETS	27.92	USAA INVESTMENT GOLD	17.91
UST MASTER EMERGING AMERICAS	27.60	MONTGOMERY EMERGING MARKETS	17.91
UNITED SERVICES GOLD	27.42	KEYSTONE PRECIOUS METALS HOLDINGS	17.61
T. ROWE PRICE LATIN AMERICA	27.14	VANGUARD SPEC. GOLD & PREC. METALS	17.31
SELIGMAN COMM. & INFORMATION A	26.89	BENHAM GOLD EQUITIES INDEX	16.99
TCW/DW LATIN AMERICAN GROWTH	26.68	MERRILL LYNCH DEVEL. CAPTL MKTS. A	16.97
MERRILL LYNCH LATIN AMERICA B	26.31	SMITH BARNEY SHEARSON PREC MET. & MIN. B	16.88
SCUDDER LATIN AMERICA	25.88	FIDELITY SELECT MEDICAL DELIVERY	16.85
FIDELITY EMERGING MARKETS	25.31	LEXINGTON STRATEGIC SILVER	16.84
G.T. GLOBAL EMERGING MARKETS A	25.12	THOMSON PRECIOUS METALS & NAT. RES. B	16.75
RBB-BEA EMERGING MARKETS EQUITY	23.59	TWENTIETH CENTURY GIFTRUST INVESTORS	16.72
VAN ECK INTL. INVESTORS GOLD	22.92	FRANKLIN GOLD	16.47
MORGAN GRENfell EMERG. MKTS. EQ.	22.80	BULL & BEAR GOLD INVESTORS	16.23
PFAMCO EMERGING MARKETS INSTL	22.71	JPM INSTITUTIONAL EMERGING MKTS. EQ.	16.19
VANGUARD INTL. EQ. INDEX EMERG. MKTS.	22.61	FIDELITY SOUTHEAST ASIA	16.16
FIDELITY SELECT PAPER & FOREST PRODUCTS	21.38	T. ROWE PRICE SCIENCE & TECHNOLOGY	16.16
LEXINGTON GOLDFUND	21.34	PIONEER GROWTH	16.15
FIDELITY SELECT DEVELOPING COMM.	20.61	PIERPONT EMERGING MARKETS EQ.	16.14
GOVETT EMERGING MARKETS	20.45	KEYSTONE AMERICA HARTWELL EMERG. GR. A	16.13

Inflation fears in the U.S. and a stabilizing political environment in South Africa fueled a resurgence in gold

Economic reforms in Latin America led funds investing in Mexico, Brazil, and Argentina to rack up hefty double-digit returns

me funds returned an average of 0.22%, while municipal funds moved up just 0.24%. Treasury-bond funds had a return of 0.17%. High-yield bond funds were the most, an average of 0.31%. That puzzles Morningstar's analyst, since high-yield funds often act like stock funds. "Whether the high-yield market is overvalued and is discounting an economic slowdown early, as it was in 1989, or there are some bargains out there," he says.

THE GOLD? The few bright spots in the bondland were in areas that had some stock market exposure, such as convertible bond funds, up 3.26%, or that tracked hot areas, such as emerging markets. The top-performing tax-exempt bond fund, for example, is the \$5 million Fidelity New Markets Income Fund, which invests in emerging-market debt and is up almost 17%. Its return is even more remarkable in light of the fund's more than 20% loss as of early August.

Robert Citrone, the fund's manager, says the overall rebound in the emerging markets fixed-income area is a comeback. Citrone had large exposures to two of the best-performing markets in Latin America, with over 20% in Brazil at one point and more than 10% in Ecuador. The fund also benefited from a

MOSTLY MIDDLING RETURNS FOR THE BIG FUNDS

Funds	Total* return	Assets** Billions
FIDELITY MAGELLAN	4.39%	\$36.7
INVESTMENT COMPANY OF AMERICA	3.87	20.0
WASHINGTON MUTUAL INVESTORS	3.27	13.3
FIDELITY ASSET MANAGER	3.09	11.8
VANGUARD/WINDSOR	0.93	11.6
FIDELITY PURITAN	2.92	11.4
INCOME FUND OF AMERICA	0.82	10.8
TWENTIETH CENTURY ULTRA INVESTORS	5.04	10.0
JANUS	2.25	9.7
VANGUARD INDEX 500	4.42	9.2

*Appreciation plus reinvested dividends and capital gains, June 30 through Sept. 26, 1994

**As of 8/31/94

DATA: MORNINGSTAR INC.

high weighting in floating-rate debt. That meant that the rise in short-term interest rates actually boosted the fund's return, since many bonds reset at higher rates.

While many gold funds sparked this quarter, Lexington Strategic Investments shone the brightest. The fund benefited from its focus on South African gold shares, which moved up more than North American gold stocks after political concerns in South Africa abated. But one gold fund ended up on the list of "worst" funds. The tiny \$1.7 million Monitrend Gold is a bearish hedged fund

that focuses on North American mining shares and didn't share in the outperformance of South African gold shares. The fund is down 5.73% for the quarter.

BULLISH OUTLOOK. What might the future hold for gold funds? Lexington Strategic Investments' portfolio manager Robert W. Radsch, who began managing the fund in July after 12 years of managing a gold fund for Bull & Bear Group, cites slowing production and steadily increasing jewelry demand as long-term positives. After trading in a fairly narrow range for most of the year, gold topped \$400 an ounce on Sept. 27 for the first time in more than a year. Yet gold funds are notoriously volatile and are best used as part of a diversified portfolio.

Many funds that explored the wilds of the emerging markets find themselves on the top 50 list. The biggest winners were a few small, barely year-old funds investing in Latin America, such as the \$30 million BT Investment Latin American Equity Fund, which took second place, and its sister fund, the \$38 million Hercules Latin American Value Fund, which was in third place. Maria Elena Carrion, the funds' manager and head of the Latin American equities team at BT Investment, says the funds were up more than 30% because her group's "pounding-the-table bullish" outlook on

THE WORST RETURNS

APPRECIATION
PLUS REINVESTED
DIVIDENDS AND
CAPITAL GAINS
BEFORE TAXES
JUNE 30-SEPT. 26, 1994

STEADMAN OCEAN TECHNOLOGY & GROWTH	-10.53%	MORGAN GRENFELL INTL. SMALL CAP EQUITY	-2.34%
DFA JAPANESE SMALL COMPANY	-8.52	COHEN & STEERS REALTY	-2.16
G.T. JAPAN GROWTH A	-7.20	AMERICAN CAPITAL REAL ESTATE SECS B	-2.11
CAPSTONE NIKKO JAPAN	-6.82	VANGUARD INTL. EQUITY INDEX PACIFIC	-2.07
T. ROWE PRICE JAPAN	-6.70	FIDELITY REAL ESTATE INVESTMENT	-2.06
MONITREND GOLD	-5.73	PRA REAL ESTATE SECURITIES	-1.90
FIDELITY JAPAN	-5.64	CGM REALTY	-1.90
JAPAN	-5.19	GROWTH FUND OF WASHINGTON	-1.81
FIDELITY SELECT AUTOMOTIVE	-5.02	SMITH BARNEY SHEARSON UTILITIES B	-1.81
CAPSTONE NEW ZEALAND	-4.88	STEADMAN INVESTMENT	-1.80
WRIGHT EQUIFUND-JAPANESE NATL. FID. EQ.	-4.87	SEI INTERNATIONAL PACIFIC BASIN A	-1.64
FIDELITY SELECT BROKERAGE & INVESTMENT	-4.81	CAPSTONE FUND OF THE SOUTHWEST	-1.53
FIDELITY SELECT NATURAL GAS	-4.28	FIDELITY SELECT UTILITIES GROWTH	-1.53
MORGAN STANLEY INSTL. JAPANESE EQUITY	-4.03	FIDELITY SELECT ENERGY	-1.52
ROBERTSON STEPHENS CONTRARIAN	-3.88	INVESCO STRATEGIC ENERGY	-1.51
RYDEX URSA	-3.32	EAGLE GROWTH	-1.42
STEADMAN AMERICAN INDUSTRY	-3.31	JOHN HANCOCK FREEDOM NATL. AVIA. & TECH. A	-1.30
PIONEER WINTHROP REAL ESTATE INVMNT.	-2.94	CAPITAL GROWTH A	-1.24
DREYFUS STRATEGIC GROWTH	-2.90	DFA/AEW REAL ESTATE SECURITIES	-1.24
EV MARATHON TOTAL RETURN	-2.74	PAINWEBBER GLOBAL ENERGY B	-1.24
UNITED SERVICES REAL ESTATE	-2.64	STATE STREET RESEARCH GLOBAL ENERGY A	-1.18
MERRILL LYNCH PACIFIC B	-2.60	CAPITAL GROWTH INVESTMENT	-1.18
COLUMBIA REAL ESTATE EQUITY	-2.57	CALDWELL & ORKIN AGGRESSIVE GROWTH	-1.14
PAINWEBBER EUROPE GROWTH A	-2.57	PIERPONT INTERNATIONAL EQUITY	-1.14
EV TRADITIONAL TOTAL RETURN	-2.51	WPG DIVIDEND INCOME	-1.08

The land of the rising sun became the land of declining returns: Japan funds, the first-half favorites, fell from their lofty highs

Utilities lost their glow as increasing competition led to the unthinkable: Some utilities cut their dividends in 1994

HOW THE FUND GROUPS FARED

APPRECIATION PLUS
REINVESTED DIVIDENDS
AND CAPITAL GAINS
BEFORE TAXES

JUNE 30-SEPT. 26, 1994

Fund group	Total return	Total return	Total return
SPECIALTY-PRECIOUS METALS	15.46%	EUROPE	3.32%
SPECIALTY-HEALTH	11.64	EQUITY-INCOME	3.20
SPECIALTY-TECHNOLOGY	11.50	ASSET ALLOCATION	2.58
MAXIMUM GROWTH	6.92	BALANCED	2.40
SMALL COMPANY	6.78	SPECIALTY-MISCELLANEOUS	1.70
FOREIGN	6.75	SPECIALTY-UTILITIES	1.62
PACIFIC	5.66	INCOME	1.01
WORLD	5.08	SPECIALTY-FINANCIAL	0.57
GROWTH	4.71	U.S. DIVERSIFIED EQUITY	4.82
SPECIALTY-NATURAL RESOURCES	4.45	ALL EQUITY FUNDS	5.18
GROWTH & INCOME	3.66	S&P 500	4.19

Taking risks—especially abroad—was the name of the game. International equities outperformed domestic stocks for yet another quarter

the markets at the end of the second quarter proved on the mark. The funds moved into markets that had been clobbered in the first half, heavily overweighting in Argentina, Brazil, and Mexico, reducing the fund's cash position to the smallest ever. Since then, Carrion has been shifting a bit out of Brazil and into Mexico and Argentina. Should the Brazilian stock market lose 15% to 20% of its value, Carrion says she would look at it again.

A soaring Brazilian stock market also buoyed the performance of the fourth runner-up for best equity fund, the \$342 million GT Latin America Growth A Fund, up almost 31%. Investment manager Soraya Betterton gives a 40% weighting in Brazil credit for much of the increase. Brazilian equities were helped by the success of former Finance Minister Fernando Henrique Cardoso's currency reform, which helped reduce the inflation rate from 45% to 50% per month back in July to under 1% currently. Also helping the São Paulo Stock Exchange is the strong standing of free-market advocate Cardoso in the polls, making it likely that he will win the presidential election in October. "In the

medium-term, Brazil has the most potential in Latin America," says Betterton. "But it is also perhaps the most vulnerable to a near-term correction."

GROWTH FOCUS. Not all the kudos go to funds that invest overseas, however: Merger mania boosted health funds into the second-best-performing equity group, up 11.64%. Technology funds took third place, rising 11.5% after enjoying a big rally in August. That moved \$220 million Seligman Communications & Information A Fund into 11th place for the quarter, up 26.89%. The fund has about 35% of its portfolio in semiconductor-related stocks. The fund's top holdings include EMC, a maker of memory devices for mainframe computers; Advanced Micro Devices Inc., an Intel Corp. rival in the race to come out with the new generation of microprocessors; and Parametric Technology Corp., a software maker.

Looking ahead, fund experts speak of a coming turn from value stocks to growth stocks. "After 2½ years, growth stocks are quite reasonably valued relative to value stocks, and the cycle is ready to turn," says Rekenenthaler. The question is when. Investment manager

Kurt Brouwer of San Francisco-based Brouwer & Janachowski, says he is already starting to look more at growth stocks. He likes the Warburg Pincus Emerging Growth Fund as well as the Janus Fund, both of which "can really run fast when things turn around."

Money continued to flow into equity funds in the third quarter. Net new cash flow into stock funds was \$14.1 billion in August, up from \$9.2 billion in July, and \$12.2 billion in August of 1993. So far this year, the flow of money into equity funds is up 12.4% compared with the same period in 1993—which was a record year. At T. Rowe Price Associates Inc. "we're running ahead of last year's record pace for equity funds," says spokesman Steven Norwitz. Cash flow into domestic equity funds has doubled, he says, and it's up 61% for international equities.

Bond funds are a different story, with the industry experiencing a continued net outflow of money. "It's like Chinese water torture," says Norwitz. "Every month, a little more money leaves bond funds." Some of that money is finding a new home in money-market funds. For example, Norwitz says that \$500 million of the \$525 million flowing into T. Rowe Price's money funds thus far in 1994 came from exchanges out of other T. Rowe Price funds. Such an inflow into money funds contrasts with the first eight months in 1993, when \$454 million flowed out of T. Rowe Price's money funds.

If there's any wisdom to be gained from the third quarter's results, it's that chasing trends, such as riding on the coattails of the quarter's winners, can do serious violence to your portfolio. In a tumultuous quarter when so many abject losers turned into high-flyers and vice versa, the smartest move might be to ignore the crowd, study the numbers, and come up with your own recipe for success.

By Suzanne Woolley in New York

THE BEST-PERFORMING BOND FUNDS

TAXABLE FUNDS

	Total return*
FIDELITY NEW MARKETS INCOME	16.72%
G.T. GLOBAL HIGH-INCOME B	9.97
ALLIANCE GLOBAL DOLLAR GOVERNMENT B	8.86
SCUDDER EMERGING MARKETS INCOME	8.43
BEAR STEARNS EMERGING MARKETS DEBT	8.13
GOVETT DEVELOPING MARKETS BOND	6.16
FIDELITY CONVERTIBLE SECURITIES	6.12
PRUDENTIAL INCOMEVERTIBLE B	6.03
DEAN WITTER CONVERTIBLE SECURITIES	5.50
ALLIANCE BOND CORP. BOND A	4.80

TAX-FREE FUNDS

	Total return*
MAS PA MUNI FIXED-INCOME	1.84%
MAS MUNI FIXED-INCOME	1.37
CGM AMERICAN TAX-FREE	1.34
CALVERT TAX-FREE RESERV. LONG-TERM A	1.20
CALVERT TAX-FREE RESERV. VT MUNI A	1.17
DREYFUS BASIC MUNICIPAL INTERMEDIATE	1.17
FRANKLIN CA TAX-FREE INCOME	1.15
SMITH BARNEY MUNI BOND CA A	1.14
SUNAMERICA TAX-EXEMPT INSURED A	1.13
HANIFEN, IMHOFF CO. BONDSHARES	1.13

*Appreciation plus reinvested dividends and capital gains, June 30 through Sept. 26, 1994

DATA: MORNINGSTAR INC.

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GLOBAL EXCELLENCE

BY GENE G. MARCIAL

U.S. SHOE AND NINE WEST: A '90s CINDERELLA STORY?

If the shoe fits, grab it. That's just what Nine West Group tried to do in August—buy the footwear operations of U.S. Shoe for \$425 million. But the offer was rejected, to the consternation of some big U.S. Shoe shareholders who felt the bid should have been accepted. Now there's talk that Nine West, a major maker of women's shoes, will return. "We believe Nine West will come back with a restructured offer that will be more compelling to U.S. Shoe," says Todd Slater of UBS Securities.

If that happens, expect U.S. Shoe's stock, trading at 20 a share on the Big Board, to kick up. Investors figure that on the whole, the stock is undervalued and is worth \$35 to \$40 a share.

Nine West's original proposal called for a two-step deal: U.S. Shoe would spin off to shareholders full ownership of its apparel and optical units, which account for about three-quarters of its revenues. U.S. Shoe's footwear business, which Ladenburg Thalmann analyst Barry Bryant estimates is worth \$475 million to \$525 million, would then be merged with those of Nine West. Dissident shareholders have been pressuring management to split the company up to extract the full value of its assets.

CLEAR VISION? Analyst Bryant says U.S. Shoe's footwear unit would be an ideal match for Nine West's operations. U.S. Shoe produces and out-sources shoes mainly in Asia and Europe. Nine West makes most of its shoes in Brazil, where it could produce certain brands of U.S. Shoe's products more efficiently and at much lower costs, notes Bryant.

Apart from U.S. Shoe's footwear division—401 stores accounting for 27% of sales last year—the company is also big in women's apparel, which generated 48% of revenues in 1993. In addition, the company makes and sells optical products through its LensCrafters unit, which generated 27% of sales.

The eyewear division has also attracted a possible buyer, says investment manager Mark Boyar, one of the shareholders backing a spin-off move. He notes that the founder and former owner of LensCrafter, Dean Butler,

U.S. SHOE COULD KICK UP SOON



has expressed interest in buying back the optical company. Boyar puts its value at \$715 million, or about \$15 a share. "That's a most conservative valuation," says Boyar. Butler owns Vision Express in Britain, an optical-products retailer, notes Boyar.

"Ultimately, U.S. Shoe will go the way of Sears Roebuck, which resisted for a long time shareholders' demand that it sell or spin off assets to enhance shareholder value," says Boyar. Management doesn't own a big stake in the company, he adds, and that's "one reason why management has been slow to react to shareholder concerns."

Enhancement of U.S. Shoe's value, though, doesn't depend entirely on a deal. Jeff Stein of McDonald & Co. in Cleveland says the company is now turning around. Absent any spin-offs or asset sales, the stock could hit 30 in 12 to 18 months. Try that on for size.

THE MAKINGS OF A DYNAMIC BANK DUO

Last August, rumors were rampant that Bank of New York, the nation's 16th-largest bank holding company, with assets of \$53 billion, would acquire Fleet Financial Group, the aggressive regional financial-services company. Fleet's stock hit 41. Most banking analysts were leery of the rumors—and both banks ignored them. Fleet's stock eased to 37.

End of story? Maybe not. Some takeover investors have been adding to their Fleet shares every time the stock dips. One buyout pro insists that talks between Fleet and Bank of New York, "have been ongoing despite analysts'

arguments to the contrary." He contends that the talks have reached a stage where "the odds have turned very favorable toward an initial agreement being reached before long" between the two banking companies. combination would create an "awesome" giant in financial services, he says.

This pro, who is betting on a takeover bid, estimates Fleet's buyout worth at \$50 a share. With assets of \$49 billion, Fleet owns about 85 branches in the New England region. And it controls Fleet Mortgage Group, which has a servicing portfolio of \$7 billion. Fleet's consumer finance, investment-service, and securities operations have also been expanding. The bank is repurchasing 4.4% of its shares.

Bank of New York's securities-processing operations, including the lucrative domestic ADR (American depositary receipt) business, has been growing at a rapid pace, notes George Salem of Prudential Securities. Fleet could give Bank of New York a far-flung branch system that would greatly expand its reach.

NOW THIS IS REAL MANAGED CARE

Most health-care stocks have been looking rather anemic so far this year. But not Medaphis, a robust provider of management services to doctors and hospitals. It has been chalking up alluring profits, pushing Medaphis' stock from 25 a share in mid-July to 36.

What drugs is Medaphis on? "Nothing but plain, old-fashioned aggressive growth and dominance in a lucrative market," says investment adviser Andrew Lanyi. Based on performance and recent acquisitions, he expects Medaphis to earn \$1.15 a share this year and \$1.50 in 1995, vs. 80¢ in 1993.

Over the past two years, Medaphis has acquired two of its biggest competitors, making it the largest provider of management services to the medical industry—a market estimated to generate more than \$30 billion in annual revenues. With Medaphis sales at only \$250 million in 1993, "its potential for sustained rapid growth is great," says Lanyi. The key to the growth, he explains, is the repeat business that Medaphis gets from its major customers.

Its most recent acquisition was AdvaCare, a provider of management services for \$38 million. AdvaCare posted sales of \$68 million in 1993.

IF YOU THINK HEALTH CARE IS EXPENSIVE NOW...



Those advocating the proposed national health care plan would have us believe that it will provide better medical treatment across the country. All Americans will be able to receive the optimum treatment, they claim. But here's what they're not telling us:

Over 87% of America *does* receive the optimum treatment now. If passed, this "national program" designed to cover the 13% of Americans without any policies will actually *reduce* the quality of health care we enjoy today and *increase* the cost we currently pay. As P.J. O'Rourke phrased it, "If you think health care is expensive now, wait until you see what it costs when it's free."

And have we ever paused to consider that this "national health care program"

is just a cover name for socialized medicine? As Americans, we know too well the plague of countries that practice socialized medicine. We see those visitors suffering various diseases come to America to receive health treatment. Why? Because in America, we enjoy the highest level of medical technology in the world. And our doctors, nurses and health care professionals are free to treat the patient, not place the person on a waiting list.

The prescription for a healthy nation is to maintain and improve our medical technology. Else, if the proposed national program is approved, we might as well just take a number.

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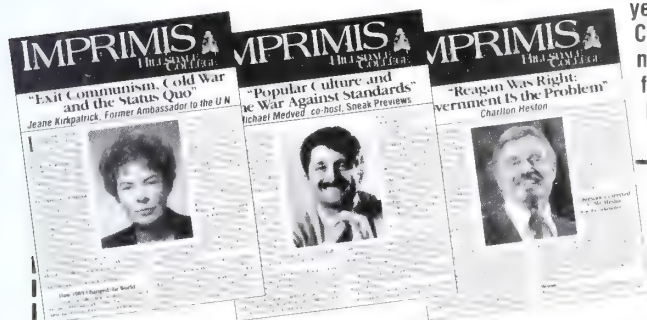
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HILLSDALE COLLEGE

A MIDDLE-CLASS TAX CUT CALLED THE IRA?

By expanding eligibility, Clinton would keep a campaign promise

The politically appealing idea of expanding tax-deductible individual retirement accounts has been advanced often by its chief advocate, Lloyd M. Bentsen. Now, Congress and the Clinton Administration are starting to appreciate the Treasury Secretary's persistence. As the President's January budget message and State of the Union speech enter the drafting phase, aides

are saving space for a proposal that could be marketed as a fulfillment of Clinton's 1992 campaign pledge to provide the middle class with a tax cut.

Support for the idea is growing, thanks to a rare alignment of political and economic forces—and the influence of Bentsen, the Administration's elder statesman. As Senate Finance Committee chairman, he pushed through an IRA expansion bill in 1992 that carried his name, only to see it vetoed by President Bush. Last year, as Treasury chief, Bentsen was poised to

virtually all workers in 1981, it proved a boon to the mutual-fund industry until Congress raided it for money to pass tax reform in 1986. Now, restoring it to its pre-1986 level—without income limits—and adjusting for inflation could cost as much as \$8 billion a year, according to some estimates.

Besides such budgetary obstacles, Bentsen must overcome arguments from some economists that IRAs are used by taxpayers merely to shuffle portfolios to tax-sheltered accounts, without producing any net savings. "If you had the banks and the mutual funds doing the selling, putting the advertisements in the newspapers, that would encourage savings," Bentsen says. Even skeptics agree that the massive ad campaigns waged by banks in the 1980s to encourage savers to open IRAs had their ef-

fect. And IRA proponents insist the savings program never got a fair test, since an increase in private savings can be expected only after some time has passed following the shift of current savings into IRAs.

Since the 1981-86 experiment, economists increasingly think it possible to craft a new IRA law that would boost private savings more quickly. "The evidence so far on whether IRAs have encouraged savings is ambiguous," concedes Council of Economic Advisors Chair Laura D'Andrea Tyson. "But this doesn't mean you can't design a system that could be targeted to produce a discernible effect on the savings rate."

OUTSIDE IDEAS. Tyson has her staff studying the effects of placing various floors and ceilings on IRA tax deductions. For example, if statistics show that taxpayers in the \$150,000 income range ordinarily save \$3,000 a year, the IRA deduction for their tax bracket could be limited to new savings in excess of \$3,000. Similarly, allowing use of the IRA for college expenses, first-time home purchases, or medical expenses (with certain limits) might also encourage participation.

Think tanks and lobbyists from the mutual-fund, banking, and securities industries are pushing their own ideas



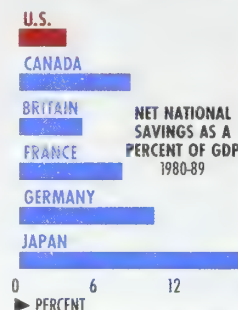
The political and economic climate has improved for Bentsen's hope of IRAs for more folks

champion his proposal again. But he reluctantly backed off after agreeing that tax hikes and spending cuts to trim the federal deficit were more important than IRAs raising the nation's savings rate.

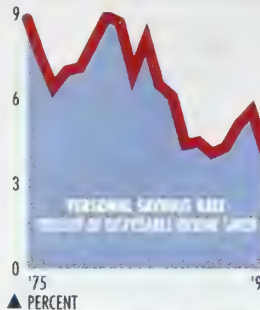
LOYAL OPPOSITION. But as Bentsen revives his pet plan for 1995, he realizes that even a modest program could meet fervent opposition within the White House. Chief of Staff Leon E. Panetta opposed expanded IRAs when he was chairman of the House Budget Committee. Office of Management & Budget Chief Alice M. Rivlin would sooner cut the deficit than provide new tax breaks. And even Treasury Under Secretary Lawrence H. Summers worries that his boss's idea may be too expensive.

The IRA, however, is too popular to ignore. Passed in 1974 and expanded to

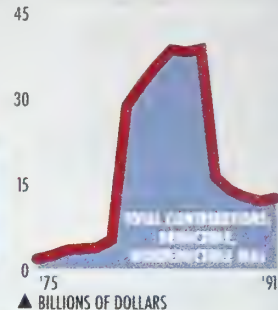
AMERICA IS HARDLY...



...A NATION OF SAVERS...



...BUT IRAS MIGHT AGAIN BE A SPUR



DATA: ORGANIZATION FOR ECONOMIC COOPERATION & DEVELOPMENT, CONGRESSIONAL BUDGET OFFICE, COMMERCE DEPT.

THE HERKY-JERKY HISTORY OF IRAS

1974 IRAs introduced in the Employee Retirement Income Security Act.

1975 IRAs become available to workers not covered by employer-retirement or Keogh plans. Limited to \$1,500 or 15% of compensation.

1981 Economic Recovery Tax Act expands eligibility to include those already covered by an employer-retirement or Keogh plan.

1982 New expanded IRA takes effect. Limit increased to \$2,000 or 100% of income. Non-working spouses eligible to contribute up to \$250.

1986 Tax Reform Act passes.

1987 New IRA laws take effect, severely limiting the IRA deduction. Only those not covered by employer pension plans or those earning less than \$25,000 (\$40,000 if joint return) are fully eligible. Spousal IRAs are limited.

DATA: BUSINESS WEEK

Administration. One from the Pro-
 sive Policy Institute would provide a
 e on the 1040 Form to direct a fed-
 income-tax refund directly to an
 Realtors, homebuilders, and univer-
 s support an expanded IRA that
 l be used for downpayments on a
 e and educational expenses, as a
 ent Senate bill provides.

Among the strongest proponents of
 expanded IRA are the President's out-
 political advisers, who fear that vot-
 will punish Clinton in 1996 unless
 takes good on his campaign promise
 middle-class tax cut. One attractive
 "family" possibility includes allowing
 working spouses to contribute as
 as \$2,000 to an IRA and take the
 deduction jointly.

The Administration is also considering
 a proposal to increase the income cap,
 which starts to phase in at the \$40,000
 income level and prohibits an IRA deduc-
 tion by taxpayers who have a joint
 income of \$50,000 or more and are cov-
 ered by a pension plan.

This makes sense, since the current
 limit and contribution limit of \$2,250
 is not indexed for inflation and haven't
 been raised since 1982. In fact, the Em-
 ployee Benefit Research Institute esti-
 mates that only 38% of joint filers will
 be eligible for the deduction by 1995,
 down from 45% in 1991. The most radi-
 cal proposal would allow workers cov-
 ered by a pension plan to deduct IRA
 contributions no matter what their
 income.

REAL SAVINGS. On Capitol Hill, the
 idea of expanding IRAs is also popular. A
 "New IRA" bill sponsored by Senate Fi-
 nance Committee members John B.
 Breaux (D-La.) and William V. Roth Jr.
 (R-Md.) quickly won 56 other co-spon-
 sors. And some 300 Republicans run-
 ning for Congress pledged on Sept. 27 to
 support a 10-part economic program that
 includes an expanded individual retire-
 ment account (page 108).

Another source of Hill support: Af-
 ter the November election, the Biparti-
 sian Commission on Entitlement & Tax
 Reform, headed by Senators Bob Kerrey
 (D-Neb.) and John C. Danforth (R-Mo.),
 reported that net national savings has
 fallen from 8% of the economy in the
 1980s to a dismal 2% today.

The biggest roadblock to an expanded
 IRA is finding a way to cover the cost.
 The plan could be linked to an entitlement-
 based proposal from the Kerrey Com-
 mission and pushed as a way to revive
 the economy. Besides, having failed to
 agree on such pocketbook issues as
 health-care reform, Clinton and Congress
 may be looking for something to give
 voters. An expanded IRA might be the
 answer.

By Paul Magnusson in Washington

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Commentary/by Howard Gleckman

THE GOP'S CAMPAIGN PLEDGE: BAD MATH, SMART POLITICS

On Sept. 27, some 300 Republican candidates for Congress—incumbents and challengers—stood on the steps of the House of Representatives and made a pledge: Elect enough of us to control the House, and we'll balance the budget, boost defense spending, and enact massive tax cuts.

As fiscal policy, the GOP's "Contract with America" reprises pie-in-the-supply-side-sky economics. Without offset-

as bigger benefits—for Social Security recipients. Among the nontax items, there's even a promise to restore much of the Reagan defense buildup, which Congress shot down after the cold war.

Of course, none of these bold plans comes cheap. Besides the huge tax cuts, the GOP proposes \$70 billion in new spending over five years. Where would it find the money? Oh, the contract claims \$40 billion in savings from welfare reform and nicks a few other

political arithmetic is solid. Taxes and big government—not race, crime, abortion, or foreign policy—are the wedge issues. It's a tried-and-true message Democrats will raise your taxes; we'll cut 'em. Says Newt Gingrich (R-Ga.), who becomes House GOP leader next year: "The tax issue has the potential to make a substantial difference."

Curiously enough, the manifesto has generated some cool responses from Republicans. Senate GOP leaders have ducked the plan. Scoffs one: "It's silly season." Some social conservatives are complaining that the contract ignores "values" issues such as school prayer and school choice. And economic conservatives fret that the plan should be pushing tax reform more aggressively. They preferred a contract endorsing the flat tax that has lately been sponsored by Representative Richard Armey (R-Tex.).

Still, the plan is in stark contrast to the Clinton agenda. And if Gingrich and company gain at least a working majority in the House, their contract will set the stage for mind-numbing gridlock. Beyond welfare reform, it's hard to find anything Clinton and Gingrich could agree on. Except one: a middle-class tax cut.

OFF THE RADAR. Clinton's political advisers have been urging him ever since the 1992 campaign to propose a tax cut. Until now, Administration deficit hawks have held sway. But if confronted with a resurgent Republican Party pushing to cut the average American's taxes, Clinton may have no choice but to preempt the opposition. He won't go for the kind of budget-buster the GOP is peddling, but he may offer a modest tax cut, such as expanded IRAs (page 106) or a new child-care credit.

In the end, taxes may not turn the election tide. Andrew Kohut, director of the Times Mirror Center for People & the Press in Washington, says the issue barely shows up in his polls. But that hardly matters. If the GOP makes big gains in November, it will claim a mandate for lower taxes and less government. And with a Democratic President's grudging help, it may deliver on at least one piece of its pledge.

Washington Correspondent Gleckman covers economic policy.



GOP CANDIDATES SHOWING THE FLAG: THEIR PLAN INCLUDES \$200 BILLION IN TAX CUTS

ting spending cuts—and with the national debt approaching \$4 trillion—promising \$200 billion in tax breaks is like running for high school class president by promising to put Coke in the water coolers.

Nevertheless, as a political manifesto, the pledge is a potent message to President Clinton and congressional Democrats. The Republicans not only believe they can win on the tax issue in November but they're also confident that they can force Clinton to back a tax cut before the 1996 election. They may be right.

GOLDEN OLDIES. Harking back to Ronald Reagan's glory days, the GOP agenda includes expanded individual retirement accounts, a capital-gains tax cut, more deductions for small business, a new cost-recovery system for capital investment, and tax breaks—as well

government programs. But those cuts, even if achieved, are barely a downpayment. And Republicans have even bigger plans in mind: They want a Constitutional amendment requiring a balanced budget. Doing that in, say, seven years, would require an additional \$1 trillion in spending cuts. The "contract" is silent on how that hurdle would be cleared.

Although the budget numbers don't add up, the GOP is convinced that the

Not all Republicans are behind Newt Gingrich's manifesto: Senate leaders are surprisingly silent

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VALLEY FOR
THE TREES CAN
RESULT IN
SHORT-
SIGHTED *AND*
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THE RJR-BORDEN DEAL: IS THE INVESTOR THE ODD MAN OUT?

Shareholders fear that KKR's latest buyout has only one clear winner: KKR

When Kohlberg Kravis Roberts & Co. announced its bid on Sept. 12 to buy Borden Inc., shareholders in the struggling food giant howled. The deal calls for KKR to acquire Borden in exchange for some 275 million RJR Nabisco Holdings Corp. shares. But the transaction values Borden's stock at just \$14.25—a 23% premium over the market price. That's cheap by takeover standards—especially since Borden stock hit 35 two years ago.

Now, as KKR and RJR managers try to pacify Borden investors and close the deal by yearend, a new outbreak of shareholder disaffection has erupted closer to home: at RJR Nabisco. And it's not just the potential dilution of their stakes that investors find upsetting. Many institutional holders are fearful that Borden shareholders, uncomfortable with owning a tobacco company, may dump their RJR shares, scuttling chances of a long-awaited revival in the stock.

They're also worried that the deal is merely the start of a clever strategy to allow KKR to exit RJR Nabisco at other shareholders' expense. One frequently suggested scenario: KKR could force RJR to buy some Borden brands at premium prices. "I don't want to see KKR using RJR Nabisco as a funneling tool and selling all the Borden pieces to them," says Gregory Jackson, a portfolio manager at Yackman Asset Management Co., which owns 5 million RJR shares.

COOKIE JAR. Perhaps most frustrating to shareholders: The Borden deal and its potential aftermath come at a time when the outlook for RJR Nabisco—and its stock—is the most upbeat it's been in years. Since KKR recruited ConAgra Inc.'s Chairman Charles M. "Mike" Harper, 67, to replace Louis V. Gerstner Jr. in May, 1993, RJR Nabisco looks reinvigorated. Nabisco Foods Group has launched several successful products, including Snack-Well's reduced-fat cookies and crackers. Even the tobacco business is thriving, thanks to more pricing flexibility and an upsurge in cigarette consumption among young people. Although RJR reported poor results last year, analyst Marc Cohen of Goldman, Sachs & Co. figures that

RJR Nabisco's operating earnings could climb 18% this year, to \$3.4 billion, as its sales rise 4%, to \$15.7 billion. KKR and RJR defend the proposed Borden purchase. "KKR believes that RJR Nabisco investors will benefit by participation in RJR's direct investment in Borden," says a spokeswoman for the LBO firm. But with RJR in registration with the Securities & Exchange Commission to issue stock for

earlier in the year. And RJR management, shareholders say, hasn't been too sympathetic to investors' concerns. "I think Nabisco, no one is a big shareholder except KKR," gripes Jackson.

The complicated Borden deal is just KKR's latest affront to shareholders, says some investors. If the KKR-Borden acquisition goes through, KKR will exchange roughly half of its stake in RJR for all of

RJR'S HARPER: IF HE GETS STUCK WITH BORDEN BRANDS, WILL HE NEGLECT NABISCO?



the Borden deal, RJR and KKR declined to elaborate.

RJR shareholders have never been an altogether happy lot. Ever since KKR acquired RJR in a leveraged buyout in 1989, shareholders have felt short-changed. RJR has poured its cash into paying off the \$25 billion in debt it accumulated in the LBO. Meanwhile, sales and profits have been erratic, while RJR's share price has languished (chart). At 6%, it's down from

Borden. Then, KKR will sell 20% of Borden to RJR for \$500 million, with an option to buy another 10%. Rather than use cash to buy its minority stake in Borden, RJR will issue about 77 million new shares of stock.

Whether Borden shareholders hold on to their RJR stock or quickly unload it is the most immediate concern to RJR investors. Tobacco turns off many investors nowadays. "It's possible Borden share-

ers will be in a selling mode when receive their [RJR] shares," says Ar-Cecil, an analyst at T. Rowe Price Associates Inc., owner of about \$20 million worth of RJR preferred stock. Such isn't unfounded. Robert Monks, a principal at LENS Inc., owner of 1.7 million shares, already vows to dump RJR shares he receives.

IT STINKS. The potential dilution of holdings has also fueled investor angst. True, the new shares issued by KKR would represent only 5.5% of the outstanding common. At most, analyst estimates, it might knock a penny off this year's expected earnings per share of 37¢. But only last April, RJR issued 250 million shares, or roughly \$2 billion worth, of preferred equity redemption-cumulative stock (PERCS). Each PERCS can be convertible into a share of RJR common stock in three years. And another class of PERCS, issued in 1991, matures due this November.

All told, RJR's outstanding common

Suspicion is rife that KKR's underlying motive is a craftily staged exit from RJR Nabisco

brands from KKR. But other investors aren't so sanguine. They doubt KKR has any grand ambitions to resuscitate Borden. So selling off assets at exorbitant prices to RJR makes sense, they contend. It could also allow KKR to salvage some returns at RJR's expense as the LBO firm quietly retreats from RJR. Such leading Borden brands as ReaLemon juice, Cracker Jack, and Creamette pasta could fetch a total of \$1 billion.

And if RJR does pay a stiff price for Borden brands, Harper and his management team might not devote as much time to building Nabisco's brands. For

already shifted RJR's focus away from downsizing. In RJR's 1993 annual report, Harper wrote that RJR's "top three priorities [are] earnings... earnings... earnings." And that message has spread through management ranks. Senior RJR executives sport "E" pins in their lapels.

But it's not just the atmospherics that's exciting institutional holders. After several lackluster years, Nabisco Foods is humming. In addition to SnackWell's cookies, Nabisco's flavored fruit Newtons and Chunky Chips Ahoy are hits. The news is also better on the tobacco front. After last year's painful price wars, R. J. Reynolds is bounding back. Thanks to price reductions, sales of RJR's premium Camel and Winston brands have climbed. And analysts widely believe that the company will raise premium cigarette prices by as much as 3% to 4% in November.

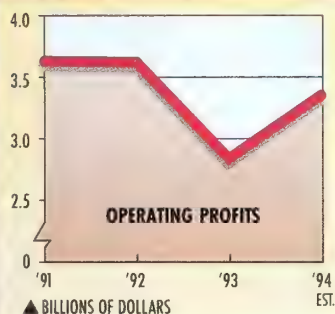
STAGE SET. Despite all the apprehension surrounding the Borden deal, shareholders say they are confident that the anticipated spin-off of Nabisco Foods won't be delayed. Ironically, the Borden deal makes the spin-off more likely. After all, a giant food company with both Nabisco and Borden brands could be far more appealing to investors, or perhaps to an acquirer such as Nestlé, Grand Metropolitan, even Philip Morris.

Analyst Gary Black of Sanford C. Bernstein & Co., which owns 19 million RJR shares, believes November could mark the beginning of end for the combined RJR Nabisco. That's when the Borden transaction is likely to close—and when KKR will want to enhance the value of RJR stock and so reduce the number of shares it must exchange for Borden. To do that, Black figures, RJR may raise \$1 billion by spinning off an initial 15% to 20% of Nabisco Foods and then sell the rest in two to three years. Federal tax laws require a two-year delay between spinning off a portion of a company and then selling the remainder. Also in November, 210 million of RJR's PERCS convert to common stock. PERCS holders have been receiving an 84¢ annual dividend, and Black thinks RJR will announce a long-awaited 30¢ to 35¢ dividend to keep the former PERCS holders from dumping the common. RJR wouldn't comment on the likelihood of this scenario. "We look at all kinds of options, ranging from doing nothing to doing a whole lot of things," says an RJR spokesman.

Ultimately, the split could set the stage for KKR's final exit from RJR, since a breakup could enhance the value of its RJR investment. True, the Borden deal may seem scary to investors now. But if it hastens KKR's departure from RJR in a few years, shareholders just may change their minds.

By Laura Zinn in New York, with Greg Burns in Chicago

WITH RJR'S EARNINGS DISAPPOINTING...



...AND ITS STOCK LANGUISHING...



...MANY INVESTORS ARE COOL TO THE BORDEN DEAL

Among the issues worrying RJR shareholders:

- ▶ Borden shareholders may be unwilling to own stock in a tobacco company and could be tempted to sell the RJR shares they get from KKR
- ▶ RJR's decision to buy an additional 20% stake in Borden with about 77 million newly issued shares of RJR stock will dilute RJR investors' holdings
- ▶ Digesting Borden's brands could distract RJR's management from building Nabisco Food's brands, which have had mixed success
- ▶ RJR shareholders fret that KKR could try to sell some of Borden's big brands to RJR at premium prices

DATA: COMPANY REPORTS; GOLDMAN, SACHS & CO.; BRIDGE INFORMATION SYSTEMS INC.; BUSINESS WEEK

and increase 40% by 1997. Harper "is digging the hell out of our stock, and I really think that stinks," complains Robert Kleinschmidt, president of Tocque Asset Management, which owns 100,000 RJR shares.

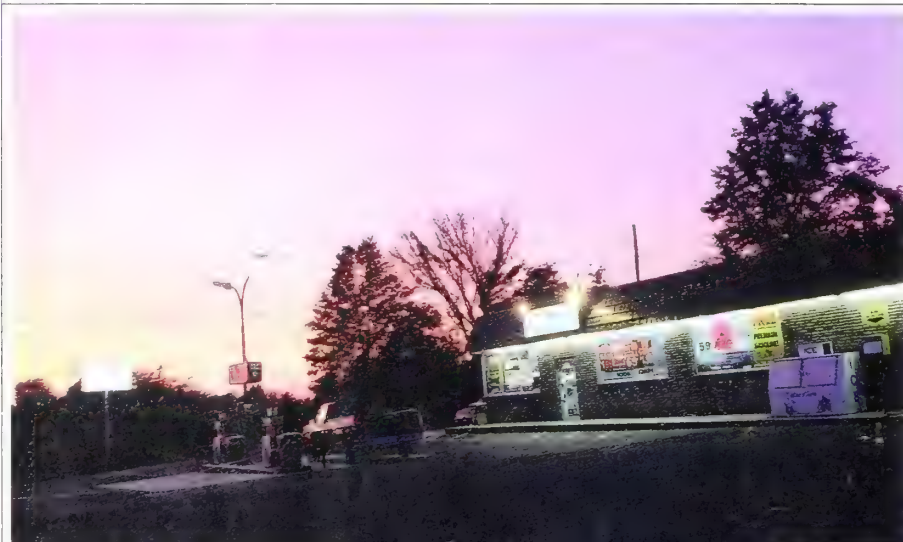
Still, the speculation about subsequent Borden-RJR deals has shareholders most worried up. One large RJR shareholder says Harper has assured her that RJR won't be disadvantaged "if RJR buys Borden

now, Harper will sit on Borden's board and won't take a direct hand in managing its brands. But RJR investors fear he may end up playing a greater role at Borden.

For the time being, however, shareholders are pleased with Harper's performance. In contrast to Gerstner, a financial engineer who spent much of his RJR tenure selling assets and cutting costs, Harper gained a reputation as a brand-builder at ConAgra. And he has

THE CURDLING OF DAIRY MART

A management feud and richer rivals have clobbered the chain



THE CHAIN'S STOCK HAS TUMBLED 60%, TO 3, SINCE JANUARY

It may not have been a sure thing, but it looked promising enough. At least that's what executives in Dairy Mart Convenience Stores Inc. believed when they joined a management buyout led by then-President Frank Colaccino in 1992. The nation's third-largest convenience-store chain, after 7-Eleven Stores and Circle K, Dairy Mart looked healthy. There was even talk that it would someday top \$1 billion in sales. That proved a powerful lure. Philip Morris Cos. invested \$8 million in the deal, and the state of Connecticut lent Dairy Mart \$7 million.

Two years later, the Dairy Mart buyout has curdled. After a profit of \$4.8 million in 1992, the Enfield (Conn.)-based company lost \$6.8 million in 1993. It earned a meager \$866,000 in fiscal 1994, which ended Jan. 31, as sales fell 1.8%, to \$761 million. Worse yet: Its stock has tumbled 60% since January, to 3.

SOURING. And as the company's financial condition has soured, so have relations among Dairy Mart's executives. On Aug. 25, the board fired Colaccino, 44, and changed the locks at the company headquarters. In turn, Colaccino, who owns 3% of the company, filed suit against Dairy Mart, trying to unseat his opponents on the board. On Sept.

18, the board agreed to pay Colaccino \$1.8 million to drop his legal challenge. On top of all this, the Connecticut Development Authority says Dairy Mart violated one of its loan covenants by firing Colaccino without notifying officials. If so, Connecticut could lay claim to 40% of Dairy Mart's voting stock.

Founded in 1957 by Charles Nirenberg, Dairy Mart was an entrepreneurial success story. Starting out selling milk and ice cream, the chain grew steadily. By the late 1980s, it had over 1,000 stores, from Massachusetts to Tennessee. And its sales were growing by an average of 100% a year. But in the 1990s, the chain faced new rivals: cash-rich oil companies, such as Amoco Corp. and British Petroleum Co., which are adding minimarts to their gas stations.

Dairy Mart needed bigger stores and more shelf space to compete. But by 1992, insiders say Nirenberg, then 68, was more interested in selling off some of his shares than in revitalizing the chain. So Colaccino, along with CFO Gregory G. Landry and Executive Vice-

Presidents Robert B. Stein Jr. and Mitchell J. Kupperman, suggested a buyout. Nirenberg agreed.

Before long, HNB Investment Corp., a unit of Philip Morris, invested in the deal. Analysts say the tobacco giant, which won't comment on its investment, wanted to make sure that its products, from beer to cigarettes, would have lots of shelf space in the chain. Then, after Dairy Mart warned that it might move its headquarters out of state, Connecticut offered a loan to help finance the buyout. Nirenberg, who had 67% of the voting shares in the publicly traded company, received \$22.3 million for his stake. **OFF THE PACE.** Colaccino appeared to move quickly to revamp the chain, opening big Super Pumper stores that had gas pumps and deli counters. But Colaccino's fellow managers felt he wasn't moving fast enough. As sales worsened, the board fired Colaccino.

In his suit against Dairy Mart and its directors, Colaccino argued that his dismissal violated his partnership agreement with Landry, Stein, and Kupperman because management decisions had to be unanimous. He dropped the suit after negotiating a lump-sum payment of \$1.8 million, six times his base salary. Both Dairy Mart and Colaccino won't

talk about the settlement. But Colaccino says he's not bitter. "Could I have done things differently? Maybe so," he says.

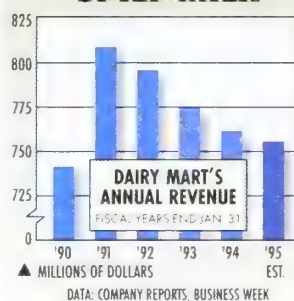
Now it's up to Dairy Mart's remaining managers to salvage the chain. They invited Nirenberg back to lend advice. Although Dairy Mart's founder won't comment, insiders say he was also upset with

Colaccino's management. Meanwhile, more Super Pumper stores are planned. The chain will also start selling fast-food items from Taco Bell, Subway, and Little Caesar. As for the state loan, Landry says he's confident he can reach a settlement. State officials won't comment. But analysts believe a deal is possible because Connecticut has little interest in owning a piece of Dairy Mart.

Still, the convenience-store business is tough these days. And Dairy Mart has lost valuable time. "You have to blame the whole company," not just Colaccino, says James Wilen, whose Wilen Management Corp. owns 9.1% of Dairy Mart's stock. If there's any promise left in Dairy Mart, executives had better start showing results.

By Chris Roush in Enfield, Conn.

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A BRAWL THAT'S HARDLY IN THE OLYMPIC SPIRIT

Bad blood between the Paralympics and the USOC spills into court

In 1979, about two years after a train accident severed his legs, Andy Fleming led a charge in Santa Barbara to create recreational sports programs for physically disabled athletes. The city council eventually bought into Fleming's plan—and then hired him to run the new program.

It has been a fast ride from there to what will likely be the biggest event ever for disabled athletes: the 1996 Atlanta Paralympic Games. With more than 4,000 athletes, 17 events, and a budget of \$100 million, the Paralympics have taken disabled athletes to heights Fleming never imagined.

He also never imagined such big headaches. As it solidifies its place in the world of big-time sporting events, the Paralympics finds itself in a high-stakes game of hardball politics. Fleming's organization, the Atlanta Paralympic Organizing Committee (APOC), is now suing the U.S. Olympic Committee over the rights to Blaze, the Paralympics' colorful phoenix mascot, which is expected to deliver as much as \$25 million in licensing fees. Meanwhile, the Paralympics' image is being hurt by a squabble with mentally disabled athletes crying foul over their exclusion from the Atlanta games. Both flaps could hurt the APOC's fund-raising efforts. Says Fleming: "The more we do to elevate the status of the [parathletic] movement, the more opportunity there is for these kinds of problems."

If that's the case, Fleming will have his hands even fuller. The 1992 Paralympics in Barcelona attracted 1.5 million spectators. The APOC is "confident," says Fleming, it will beat that mark in 1996 and will take in \$100 million from corporate sponsors, private foundations, and licensing deals—funding sources the Barcelona games lacked. The bait: a potential audience of 31.4 million physically disabled Americans who earn a total of \$461 billion a year. That's enough to get Coca-Cola, Home Depot, and home med-



THE APOC'S FLEMING: HIGH-STAKES HARBALL

ical-equipment maker Sunrise Medical to pay upwards of \$4 million each to sponsor the 10-day competition.

It's the sound of ringing cash registers that has exacerbated the APOC's troubles with the USOC. Blaze's licensing potential is so tantalizing that the APOC set up the U.S. Disabled Athletes' Fund (USDAF) to market the mascot long after the Atlanta games are over, with proceeds to benefit physically disabled athletes. "The upside potential is enormous," says Fleming, who likens the bird's appeal to that of the Cabbage Patch Kids or Bart Simpson.

At issue: Control of royalties from Paralympics mascot Blaze after the games

Now the USOC wants its share of Blaze's action. Claiming broad ownership of the word "Paralympic" and a related logo, the Olympic Committee is disputing the Atlanta Paralympics' claims to the mascot. It wants the right of approval for any use of Blaze—and a 2.5% royalty. Unable to persuade the USOC to back off, the Atlanta Paralympics is suing. It contends that the USOC indeed has some rights to Blaze during the games but that afterward he belongs to the USDAF.

HAT IN HAND. The relationship between the USOC and the Paralympics has always been strained. Paralympians have long felt underfunded by the USOC and resent its tightfisted ownership of the Paralympic name. "We have had a longstanding disagreement with the USOC over the commercial use of the term," says Fleming. In fact, the U.S. Paralympic team had to call itself the "U.S. Disabled Sports Team" at Barcelona.

For its part, the USOC expresses surprise at the Paralympics' lawsuit, especially since it advanced \$500,000 last fall when Fleming came hat in hand because the Paralympics couldn't meet its payroll. "Some of that money is being used to sue the USOC," complains outgoing USOC Executive Director Harvey Schirer. But the APOC notes that the loan was contingent on its having to sign an agreement that restricts it from selling sponsorships to rivals of Olympic Games sponsors. "It was not a completely unanimous gesture," says Fleming.

The same could be said about the Paralympics' attitude toward athletes with mental handicaps. The APOC is refusing a petition by the Belgium-based International Association for Sport for People with Mental Handicaps to allow some of its stars to compete in Atlanta, saying that such inclusion would muddy its efforts to promote athletes with physical disabilities. Bernard Atha, head of the Belgian group, vows that he will raise the issue with Paralympics sponsors. "There will be an international outcry which will inevitably damage the Paralympic movement," Atha warns. Says Fleming: "We don't see this as having any impact on our games."

Ah, the joys of the big time playing field. It makes you wonder: If the Paralympics can't be held without acrimony, what hope is there for that old-fashioned notion called sportsmanship?

By Jonathan Ringel in Atlanta
with Heidi Dawley in London



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9

A FEAST FOR SMALL FRY—OR DESSERT FOR THE BIG GUYS?

An attempted FCC good deed may not stop industry consolidation

As an investment banker, former Atlanta Mayor Maynard Jackson knows a good deal when he sees one. So when Congress last year O.K.'d the auction of licenses for a new wireless telephone service—with special breaks for minorities and some other bidders—Jackson decided to try his hand at telecommunications. "We're very excited about the potential," says Jackson, who plans to bid through a newly formed company, Jackmont Entermmedia Inc.

He has good reason to be. As a "designated entity" (DE)—the Federal Communications Commission's term for qualifying minority-owned, women-owned,

from rural lawmakers, backers of affirmative action, and small-business boosters. The bill includes preferences for rural phone companies.

Nearly half—986 out of 2,074 PCS licenses—will be set aside for DEs. The rationale: make sure the kind of entrepreneurs who made cellular a dynamic business get in. Also, lawmakers wanted to redress the underrepresentation of women and minorities in communications. "This has been such a lily-white, male industry for so long," says Donald Gipps, deputy chief of the FCC's Office of Plans & Policy.

Whether the DE program can achieve

survive, there will still be greater competition and diversity.

For now, all sorts of people are stepping forward as DE wannabes—from former Manhattan Borough President Percy Sutton, who is looking to put together a consortium of African-American entrepreneurs, to Jorge Mas Canosa, a prominent Cuban-American contractor. He wants to run PCS systems across the U.S. but will probably focus "on licenses in the Sunbelt region such as Texas, Arizona, and California."

NO CLUE. For every savvy executive who wants to bid, however, "there are people who really don't have much of a clue," says consultant Janice Obuchowski, Bush Administration communications aide who has decided to bid herself. Not long ago, Obuchowski got a call from California lawyer who wanted to refer client. When Obuchowski asked who she might bring to the table, the lawyer said, "well, she has three benefits: She's a minority, she's female, and she's paralyzed." Says Obuchowski: "I wonder what else she has going for her?"

Indeed, one of the FCC's big concerns

is that the DEs won't get far without financial support and other assistance from major corporations. The license for Chicago, for example, could easily fetch \$100 million, and would take \$200 million more to build the system. "It's impossible for a DE to go it alone," says Terrence McGarty, president of National PCS Consortium, who hopes to see services such as billing to new licensees. "If they try, they get killed."

The FCC's solution is to make it easy for big companies to back the upstarts—or, in essence, legalize

fronting, a chronic issue in minority set-aside programs. Under the FCC's new rules, big companies can have up to 75% of the equity and can operate the PCS system, but they cannot have voting control of a DE. And no single corporate backer can hold more than 49.9% of a minority- or woman-owned DE or 25% of other DEs.

One rule—excluding any individual investor with a net worth of more than

THE ABCs OF DEs

WHAT A DE IS Congress ordered the FCC to give special breaks in the PCS auction to small businesses, minorities, women, and rural phone companies, collectively known as "designated entities." In all, 986 of the 2,074 licenses will be reserved for DEs.

WHAT A QUALIFIED DE GETS A discount of up to 25% off bids, tax certificates that defer capital gains on the sale of PCS licenses, and a 10-year payment plan—10% down and favorable interest rates.

WHAT DEs NEED In a word, capital—from big companies, which can own up to 75% of a DE. But a single backer can't hold more than 49.9% in female- and minority-owned DEs and 25% of other DEs.

WHAT THE FCC WANTS TO AVOID To curb license-flipping, a DE can't sell for three years, and FCC rules favor sales to other DEs.

DATA: FEDERAL COMMUNICATIONS COMMISSION

WHO WANTS TO BE A DE?



ROBERT JOHNSON

The founder of Washington (D.C.)-based Black Entertainment TV cable network says he is talking to a number of communications companies about joint bids.

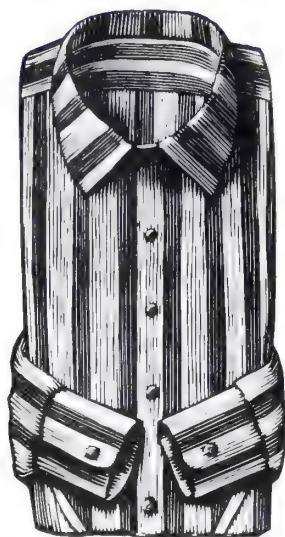


JANICE OBUCHOWSKI

As President Bush's telecommunications adviser, she helped push through spectrum-auction legislation. Now, she's a likely bidder through her company, Freedom Mobility.

and small-business bidders—Jackson stands to get a 25% discount as well as financing and tax breaks (table) in the coming auction of licenses to operate personal communications systems (PCS). The potential is so great for PCS—a low-cost cellular format that could compete with wired local phone networks—that the FCC expects total bids to exceed \$10 billion. The DE plan was dreamed up to get support for the auction legislation

those goals is a matter of debate. "This could be a great example of the adage that the road to hell is paved with good intentions," says P. William Bane of Mercer Management Consulting Inc. Like other critics of the DE plan, he fears that the small fry won't survive bruising competition with entrenched cellular providers and other wireless carriers, making the whole exercise pointless. The FCC's position: Even if only a few DEs



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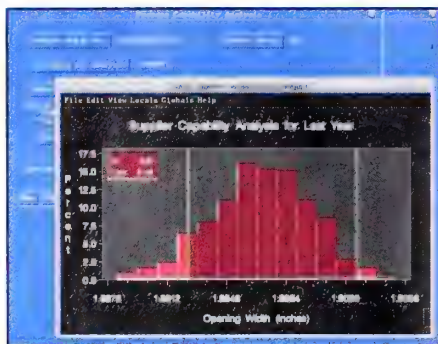
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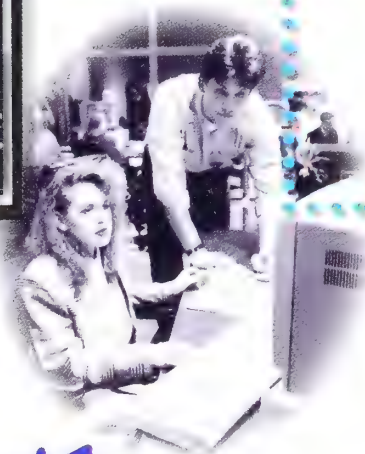
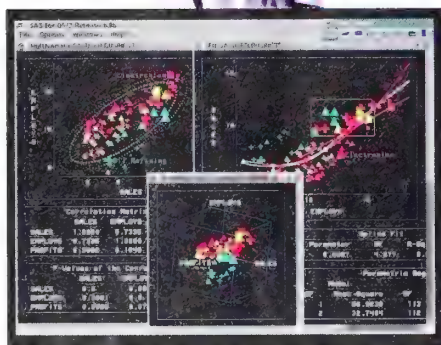
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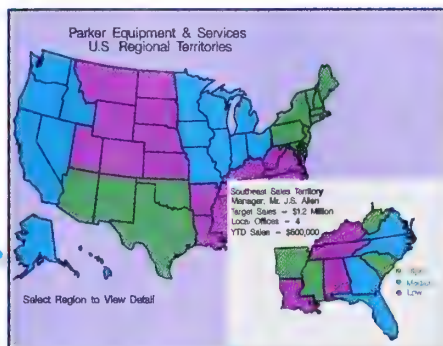
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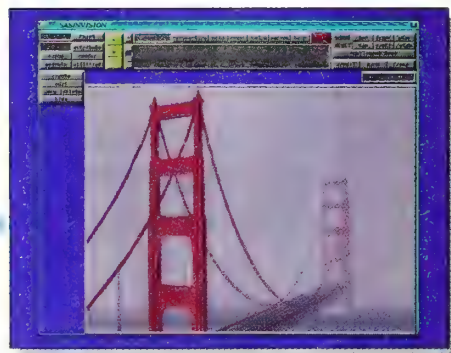
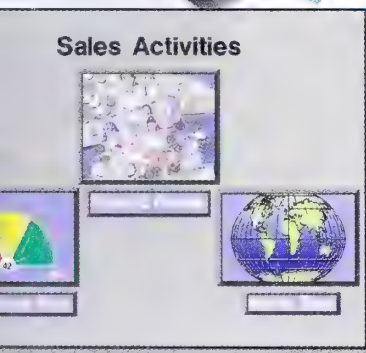
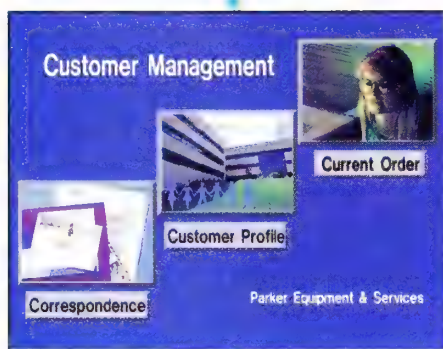
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\$100 million—could eliminate women and minorities with the greatest resources and business experience. Oprah Winfrey and Michael Jackson have been removed, and Robert L. Johnson, chairman of Black Entertainment Television Holdings Inc., says his plans could be stymied unless the rule is relaxed. "The government is all caught up in this complex sociological game," says Johnson. "They should just say this is a wealth-transfer program to women and minorities."

WINDFALLS? With an October deadline looming for the bidders in the first PCS auctions to identify their partners, the mating game is under way. "We've been contacted by somewhere between 40 and 60 DE groups," says Ameritech Corp. Vice-President Evan B. Richards. Ameritech and

other cellular operators can use PCS partners to fill gaps in their coverage areas. Under FCC rules, cellular operators can't bid on large regional licenses if they already cover more than 10% of that population. But they can join up with designated entities that bid for smaller areas.

While the FCC smiles on such part-

nering, it's out to curb license-flipping. Following the the lottery for cellular licenses in 1980s, winners reaped huge windfalls by quickly selling to big companies. To avoid that, the agency has come up with elaborate restrictions on resale of PCS licenses by designated entities.

But critics say, no matter what, the DE rules will only delay, not prevent, the inevitable contraction of the industry. "Most of the new players will be gone in a few years as the market consolidates," says Dennis Patrick, president of Time Warner Telecommunications. Even so, Time Warner has held discussions with potential bidders, including a company of Native Americans in Alaska. Being a DE may not be a shortcut to success in wireless, but owning one could be.

By Mark Lewyn
Seattle



SANDRA GOEKEN

The daughter of MCI founder John D. Goeken runs the international arm of his In-Flight Phone Corp. She founded Women of Wireless to bring others into the DE plan.



PERCY SUTTON

The former Manhattan Borough President owns stakes in a Queens cable system and radio stations. He plans to bid with Motown Records and Essence Communications.



JORGE MAS CANOSA

A prominent leader of Miami's Cuban-American community, he plans to bid through his Mastec Inc., a construction company that lays phone cables and erects phone poles.

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THE NIGHTLY BUSINESS REPORT

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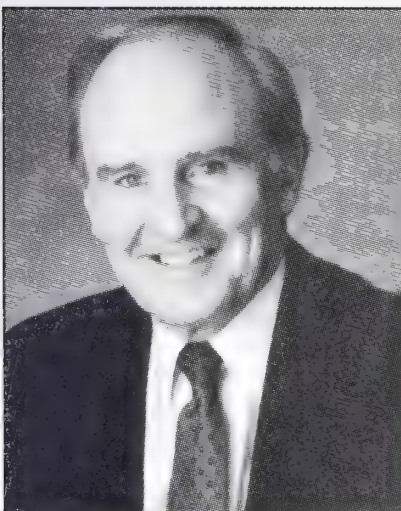
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Making Sense Of It All.

**Week of October 3
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Commentary/by Aaron Bernstein

THE U.S. IS STILL CRANKING OUT LOUSY JOBS

President Clinton took office promising to steer the U.S. onto a high-skills, high-wage growth path. In hopes of doing so, he soon launched a variety of modest programs, from apprenticeships to more assistance with college expenses.

Unfortunately, several recent reports make it clear that this effort hasn't started to pay off—even with the help of an economic expansion. Two Labor Dept. studies show that employment growth in the 1990s has been depressingly similar to that of the 1980s: An abundance of

same result—or come up with their own ideas. The Secretary suggests new tax incentives for training, for example, or voluntary commitments for workforce investments. Although Reich knows that the Administration doesn't have the clout to force ideas such as a training mandate through Congress, he still holds out the threat, at least implicitly. "If we cannot develop a superior approach, it would certainly be better to embrace [a mandate] than to abandon the goal," he warned.

There's little doubt that the U.S. isn't

Meanwhile, the study shows 1.1 million higher-wage, mostly blue-collar manufacturing jobs vanished, manufacturing. One million other new jobs in the lowest-paid service occupations, as cleaning and food preparation. trend I found is virtually the same as the '80s—a shift to lower-wage manufacturing and higher-wage occupations," says Nardone, the BLS economist who led the study. He found the same when he looked just at the 4.2 million jobs created between February 1990, when employment bottomed out

MANY NEW JOBS ARE IN HIGHER-PAID OCCUPATIONS...

NUMBER OF NET NEW JOBS CREATED FROM 1988 TO 1993, BY OCCUPATION

Occupation	New jobs Millions	Weekly wage* Dollars
Executives	1.12	\$635
Professionals	1.68	617
Technicians	0.49	495
Production	-0.74	490
Clerical	0.25	349
Laborers	-0.70	328
Sales	0.43	314
Farming	-0.05	234
Service	1.19	215
TOTAL JOBS	3.66	\$394 AVG.

*1993 AVERAGES

...BUT THEY'RE MAINLY IN LOW-WAGE INDUSTRIES...

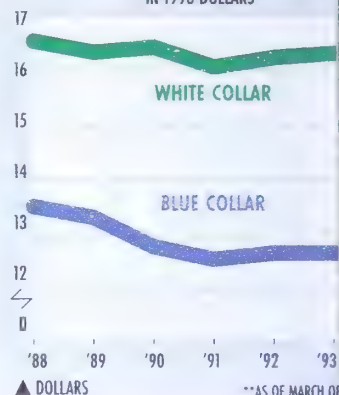
NUMBER OF NET NEW JOBS CREATED FROM 1988 TO 1993, BY INDUSTRY

Industry	New jobs Millions	Weekly wage* Dollars
Mining	-0.07	\$637
Public sector	0.30	555
Transportation	0.30	546
Construction	-0.57	454
Manufacturing	-1.74	452
Finance	0.11	448
Wholesale trade	0.22	446
Services	4.35	371
Agriculture	0.11	252
Retail trade	1.04	225

DATA: BUREAU OF LABOR STATISTICS, ECONOMIC POLICY INSTITUTE

...AND AVERAGE PAY IS STILL BELOW WHERE IT WAS IN THE '80s

AVERAGE HOURLY WAGE IN 1993 DOLLARS**



white-collar jobs have been created but mostly in lower-paid service industries—along with plenty of low-wage service and clerical positions (charts). What's more, other studies show that pay hikes for existing jobs still aren't outpacing inflation. The result is that average real wages continue to fall for blue-collar workers and remain substantially below their prerecession peak for white-collar employees.

THEIR OWN IDEAS. Now Labor Secretary Robert B. Reich is trying to put the issue back on the front burner. Only this time he plans to put business squarely in the hot seat. In a Sept. 27 speech to the National Alliance of Business, Reich said he isn't yet ready to revive some Clinton campaign ideas that riled Corporate America, such as mandating that employers spend 1.5% of their payrolls on training. Instead, he wants companies to embrace other methods for achieving the

yet moving toward a high-wage strategy. In an analysis of the 3.66 million net new jobs created from 1988 through 1993, the Labor Dept.'s Bureau of Labor Statistics (BLS) found that executive and professional employment expanded by 2.8 million. But 2.65 million of these jobs were in service industries, such as health care and lodging, which tend to pay worse than most others. For instance, a front-office motel manager earns \$18,000 to \$32,000 a year, vs. the \$40,000 to \$60,000 with overtime that a unionized auto worker rakes in.

Corporate America doesn't like Clinton's ideas for a high-wage strategy—but hasn't proposed alternatives

the recession, and in April of this

As important as net new jobs over, is what has happened to the those who are already working: 1.1 million other new jobs in the lowest-paid service occupations, as cleaning and food preparation. trend I found is virtually the same as the '80s—a shift to lower-wage manufacturing and higher-wage occupations," says Nardone, the BLS economist who led the study. He found the same when he looked just at the 4.2 million jobs created between February 1990, when employment bottomed out

DIPPED AGAIN. In fact, 3½ years into recovery there's little sign that made much difference at all. wages did rise by a slight 1.2% after inflation, they have remained have fallen every other year since

ed again, by 1% in real terms, in
ended in March of this year. Even
in such benefits as health care
ake much difference: Average
ion has lagged inflation by 2%

that, splitting the workforce into
makes it clear that all those new
and professional jobs didn't make
rence. Although white-collar pay
lightly—1.6% in real terms—since
ended in 1991, it remains 1.3% be-
8 level. And the blue-collar set is
e blues, with a 7% real decline
“There might have been a little
ages from the recovery, but the
problems are still with us,” says
hel, the Economic Policy Insti-
t economist.

ook for the future isn't much bet-
LS projects that 57% of the 26
new jobs it thinks will be created
ll be in occupations with above-av-
ings. Even if this turns out to
e, however, it says nothing about
evels of the 100-plus million people
orking. If their pay hikes continue
lation, average wages are almost
decline in real terms despite any
gher-paid new jobs.

SLUMP. It's possible that demo-
ends will produce a pleasant sur-
boomers are likely to earn more
ve into their 40s and 50s, typical-
hest-earning years. And older
ill start retiring soon, opening up
ge jobs for younger workers who
red the brunt of the '80s wage
s also conceivable that the current
eventually will lift inflation-adjust-
enough to allow the average work-
ss the 1988 peak. However, that's
y unlikely, since many economists
ther slump to begin sometime in
uple of years. And over the long
of these factors will offset the
majority of employers continues
tight lid on wages.

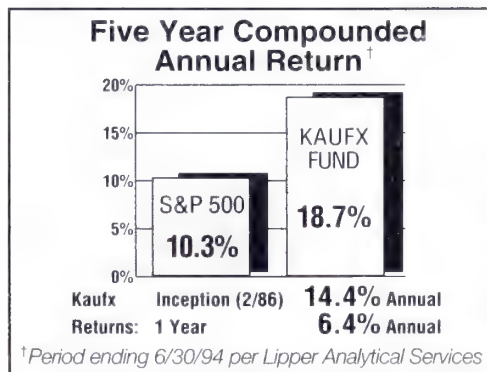
ministration was defeated in its
orts to launch a full-scale high-
egy. Now it's taking another shot
al. Corporate America has been
astic about most of the ideas so
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ns. Employers must focus first on
competitive, but they also must
rips with the continuing wage
n is right when he says that “gov-
can't do it alone. Now it's time
ivate sector to come up with in-
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THESE MOTORS SHIFT GEARS ON THEIR OWN

Energy-saving variable-speed electric motors finally catch on

In an era of megabit chips and gigabit fiber optics, the lowly electric motor is easy to overlook. Nothing "virtual" about a motor: It uses electricity to turn a shaft, which drives fans, pumps, compressors, and other holdovers from the Industrial Age. The basic science of motors isn't exactly racing forward either. Some of the best textbooks on it were written in the 1930s and '40s. In most motor purchases, the biggest factor is a rock-bottom price.

Suddenly, though, interest in new motor technology is on the rise. Credit for that goes largely to the U.S. government, which is pushing to raise the efficiency of motors. And for good reason. Motors use more than half the electricity generated in the U.S. The Energy Dept. estimates that systems powered by industrial motors consume about \$30 billion worth of electricity a year—and indirectly account for 8% of U.S. carbon emissions.

NEW HUM. The drive for motors that use less electricity is coming on several fronts. Under the Energy Policy Act of 1992, most general-purpose alternating-current (a.c.) motors from 1 horsepower to 200 hp sold in the U.S. after October, 1997, are supposed to meet an efficiency standard that is reached today by only premium units. And the National Appliance Conservation Act of 1987 requires steady increases in the minimum efficiency of equipment in the home, including refrigerators, heat pumps, and other devices driven by motors.

The government's initiatives please motor manufacturers, whose products are getting a closer look from blasé customers. In the past, buyers focused on low initial price without much regard to lifetime energy costs. Even if they wanted to take these expenses into account, they had to cope with confusing and contradictory claims from manufacturers. The 1992 Energy Policy Act gave official recognition to an industry rating system. Says John M. Hooker, man-

ager of advanced engineering for General Electric Co.'s GE Motors unit in Fort Wayne, Ind.: "There was nothing out there in the marketplace that was driving this. Now there is."

While government action has been instrumental, efficiency improvements couldn't have happened without new technology. The advances haven't come so much in the copper and iron of the motors themselves but in the electronics that control them. The biggest improve-

speeds. There's plenty of room for growth: E Source Inc., an energy-conservation researcher in Boulder, Colo., calculates that only about 10% of the machines that could benefit from 1 hp to 200 hp variable-speed motors have them today.

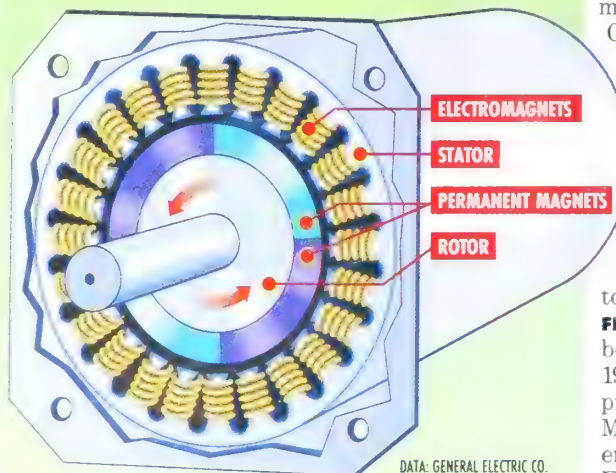
Exxon Corp. was ahead of its time with variable-speed technology for its motors. Back in 1979, its engineers devised a box that would convert the standard 50 or 60 cycles per second household current into whatever frequency a motor needed for a given speed. To market the "synthesizer," Exxon bought Reliance Electric Co. for \$1 billion. But the box was too expensive to manufacture: Exxon gave up on it a few years later and sold Reliance in 1985. With advances in power electronics, the Exxon concept has since become practical, and adjustable-speed drives for motors are sold by dozens of companies—Reliance among them.

Hooker's group at GE Motors is pushing another approach to variable speed: a direct-current motor it calls the Electronic Commutated Motor. Ordinary d.c. motors require frequent maintenance because the electrical contacts, known as brushes, wear out. The ECM is brushless. Its rotor is propelled by the complex interaction of electromagnets on an outer ring and nonelectrified permanent magnets on its rotor (diagram).

FEUDING CURRENTS. The concept behind ECM dates back to the 1920s, but credit for making it practical goes largely to Dale M. Erdman, a senior electromechanical engineer for GE in Fort Wayne. Erdman realized that brushless d.c. motors could be made much cheaper by doing away with expensive, delicate sensors that detected the position of the rotor magnets in relation to the outer ring of electromagnets. He devised a way to sense the rotor magnets' position by using "back voltage" they created in the outer ring. That was in 1976. After a few false starts, Erdman built a controller that juiced the electromagnets just right so they drove the rotor. "The first time I hooked up that circuit, the motor ran right," he recalls. "There was no adjusting or tweaking."

Erdman says he ran into flak from GE's a.c.-motor loyalists, who argued that energizing electromagnets in quick bursts was inefficient compared with riding the smooth waves of alternati-

HOW THE GE MOTOR WORKS



Motors make a shaft spin by using **electromagnets**—wire coils that become magnets when current passes through them. General Electric's variable-speed motor uses an outer ring of electromagnets to move the rotor, which is covered by four **permanent** (nonelectrified) magnets. A controller varies the **rotor's** speed through the timing and direction of currents that make each electromagnet pull on an approaching rotor magnet.

ment is in variable-speed technology. Most alternating-current motors—the most common kind—run either full speed or not at all. That's an inefficient way to perform many kinds of work, such as moving volumes of liquid and air. If electronic controllers are added to vary the speed of a.c. motors, their energy consumption can be slashed by up to 50% in some cases. A new generation of low-maintenance direct-current (d.c.) motors is also fueling the transition to variable



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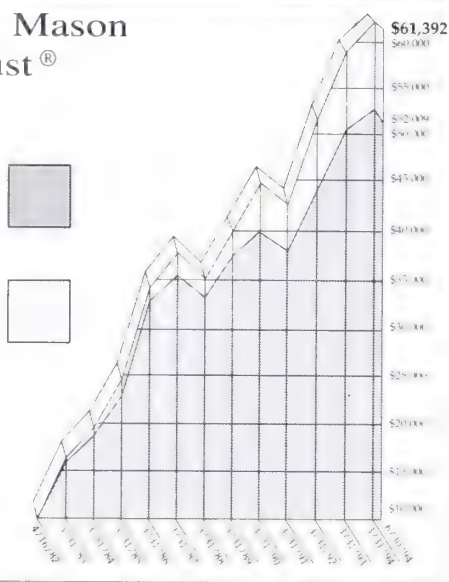
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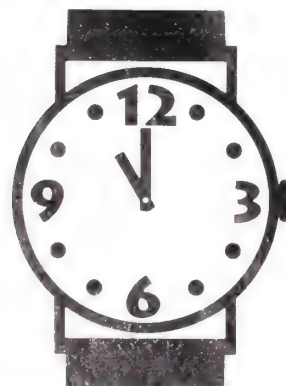
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current. To prove them wrong, he wrote a new set of motor equations. Eventually, senior GE managers bestowed the ECM team with figurative "golden bangles" that protected them from being undercut by the a.c. team.

PATENT SUIT. As hopeful as Exxon, GE bragged in 1983 when it introduced the ECM that within a decade, GE and others would sell 15 million of the type annually. But the price was too high. While growing, sales today remain a fraction of that, says market researcher Frost & Sullivan Inc. ECMs are most popular in blowers used in heating and central air conditioning. Emerson Electric Co. has a brushless d.c. motor line called VarEp, but GE leads in sales and has sued Emerson for patent infringement. (Emerson denies the allegations, and a trial is scheduled for January.)

Other efficient designs are coming. One, the switched-reluctance d.c. motor, is compact, rugged, and handles a wide speed range, making it suitable for everything from coal-mining machines to kitchen mixers. It combines a simple

The latest motors skip the entire principle of electromagnetism

mechanical system with a sophisticated electronic controller that precisely times jolts to the coils to drag an iron rotor around in circles. Experimental switched-reluctance motors were noisy and jittery, but manufacturers say they have solved those problems. Dana Corp. Warner Electric Div. in Marengo, Ill., sells them to Ford Motor Co. for cruise controls and to Hewlett-Packard Co. for drawing machines called plotters.

Still newer are motors so unusual that they don't even use the principle of electromagnetism. They're made of piezoelectric materials, which bend when voltage is applied to them. Disks of piezoelectric ceramics can be made to ripple in a stadium wave that nudges a rotor around in circles. Japanese companies hold most of the patents on the concept, with the top user being Canon Inc.'s EOS autofocus lens on cameras.

Motor technology was stagnant for so long that many manufacturers shy away from the likes of such odd ducks as switched-reluctance and piezoelectric motors. Timing, however, is critical. It could be risky to enter those markets too late—just as 15 years ago, it was risky for Exxon to push variable speed too early.

By Peter Coy in New York

TOGETHER WE CAN HELP SHAPE THE FUTURE



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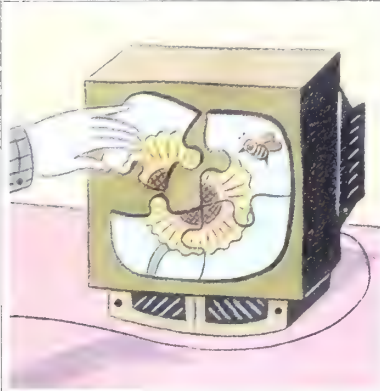
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Developments to Watch

EDITED BY RUTH COXETER

VIRTUAL VIDEO THAT LETS YOU CALL THE SHOTS



A Tennessee company has developed a "virtual eye" that lets a viewer pan, zoom, and tilt while watching video recorded by a stationary camera. Omniview is a box that goes between the video source and a monitor. It converts live or recorded video into digital format and then manipulates it. Someone watching a videoconference could tell the box

to zoom in on one person, then another. Omniview, made by TRI Inc. in Knoxville, also corrects the distortion caused by a fish-eye lens. A camera could take in a wide field of view, up to 110 degrees, and a viewer could "pan" across it.

Veterans of Oak Ridge National Laboratory began work on the system back in 1986. Just this year, TRI managed to make the system fast enough, at more than 600 million instructions per second, to manipulate live video. The first product, devised for building security, is \$9,950. Motorola Inc. bought a minority stake in the private company this year. One caveat: Omniview can't display more detail than exists in the original video stream, so extreme close-ups aren't very detailed.

FOR THOSE SICK LITTLE CIRCUITS, A PRICELY PROBE

Defects in an integrated circuit cause irregularities in electric current, which can cripple a satellite or a computer. Discovering the culprit may require chemically removing layers on the chip or cutting it in cross-sections. If engineers could just take a snapshot of all the current paths on the chip, they could trace and correct the defect.

Scientists at Sandia National Laboratories in Albuquerque, N. M., say they can do just that with a magnetic force microscope (MFM) sold by Park Scientific Instruments in Sunnyvale, Calif. The MFM generates detailed images of the IC surface, based on the minute deflection of a probe scanning the chip. The probe is fitted with a microscopic magnet that can sense changes in magnetic fields generated by the electric current on the chip. Team leader Ann Campbell says the device should help chipmakers confirm their designs as well as monitor failures. But it won't come cheap. MFMs fitted with the necessary electronics may sell for as much as \$250,000.

HOW TO TEACH PLANTS TO FOOL FUNGI

Farmers lose more than \$1 billion a year when wind-borne rust fungi attack wheat, coffee, and other crops. Threadlike rust cells invade plants through tiny breathing pores called stomata, cutting crop yields by as much as half. Cornell University plant pathologists Harvey C. Hoch and Richard C. Staples speculated that the ridges surrounding the stomata signaled the fungi where plants were vulnerable. To test their

hypothesis, they grew fungi on silicon wafers etched with different-size ridges by electron beams. "It was a marriage of cell biology and nanotechnology," says Hoch.

It turned out that fungi couldn't recognize stomata if the ridges were slightly taller or shorter than half a micron. The pair have identified the optimum ridge height that fungi recognize for more than 30 crops. Efforts to discover plant varieties with stomata invisible to fungi have so far been unsuccessful. But Hoch thinks that introducing genes from plants that have ridges all over could confuse the fungi's sense of direction and leave a plant unharmed in its wake. Fungi could then be controlled by changing the architecture of, say, a leaf rather than zapping it with chemical sprays.

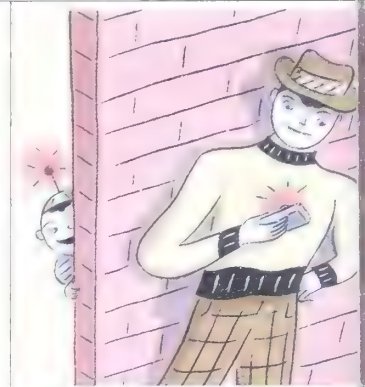
GETTING GOOD BACTERIA TO CRUNCH KIDNEY STONES

Most bacteria seek to live in harmony with their hosts. Some are even beneficial. One example is *Oxalobacter formigenes*, an intestinal bacterium associated with a reduced incidence of kidney stones, an ailment that affects some 25 million Americans over a lifetime. Scientists at the University of Florida in Gainesville have isolated two genes from this bacterium that may pave the way to gene therapy for kidney stones.

Pathology professor Ammon B. Peck and his colleagues have identified two genes that direct the production of enzymes that break down oxalic acid. Left alone, oxalic acid binds with calcium to form crystals that solidify into painful stones. Peck introduced the genes into embryonic rat tissue and will soon graft the tissue into kidneys of adult rats. The rats will be fed a high-oxalate diet to see if the genetically engineered tissue can stop the formation of kidney stones. He has also put one of the genes into human fetal tissue, but human trials are several years away. Ixion Biotechnology Inc., a startup in Alachua, Fla., is funding the trials and will soon market a supersensitive dipstick test for oxalic acid that was developed by the same team.

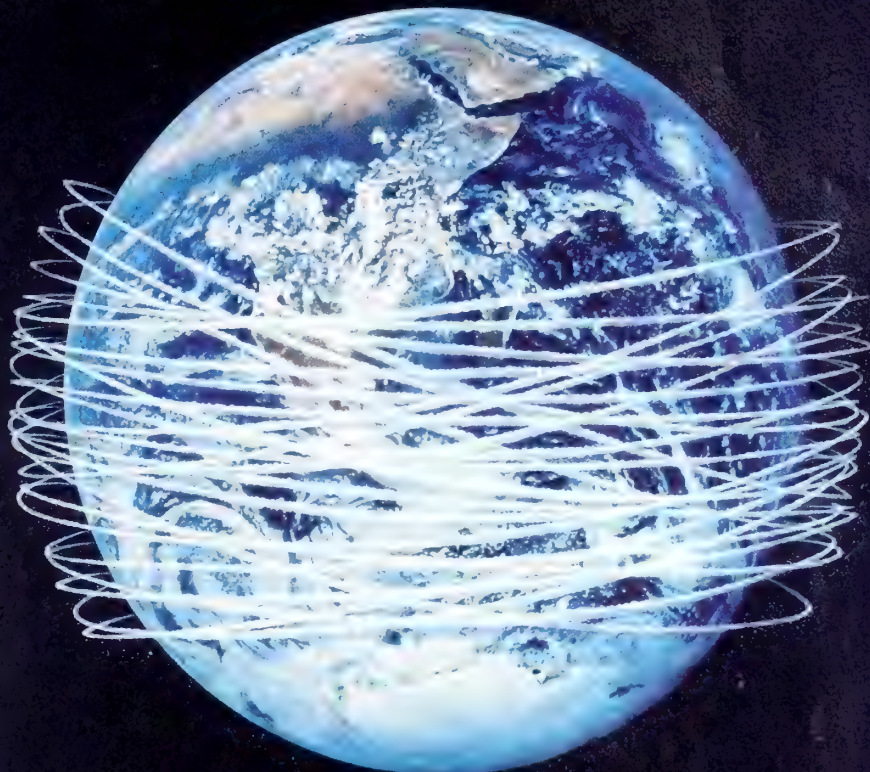
THIS BENEVOLENT BEEPER KEEPS AN EYE ON THE KIDS

Technology that troops use to locate friendly forces may give parents a strategic advantage. With help from defense contractor Harris Corp. in Melbourne, Fla., a Long Beach (Calif.) startup has developed a beeper system that warns parents when a child strays more than 15 feet. Existing products measure radio-wave signal strength. But they have been plagued with false alarms caused by interference from walls and store security systems.



A+H International's BeeperKid works differently. The child's transmitter sends two signals: One identifies the child. The other, A+H says, is a low-frequency signal that drops off sharply in intensity beyond 15 feet. The parent's unit has to receive both or an alarm goes off. A+H won't say why the low-frequency signal drops off sharply, a phenomenon that seems to defy principles of radio transmission. BeeperKid sells for \$150.

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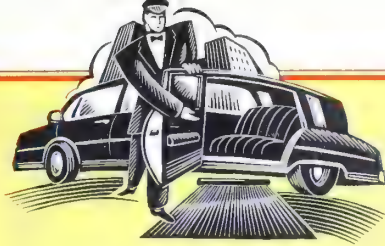
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workers' compensation reform, regulatory reform, tax reform and dozens of new partnerships with businesses. And without that spirit, there wouldn't be TeamCalifornia, a statewide alliance of government and business people who (1) don't draw lines; (2) are sponsoring this message; and (3) can help your company go places in California. To learn how TeamCalifornia can help you determine the growth possibilities for your company, or for more information about your company's potential in California, call 1-800-326-2606.



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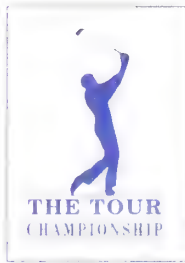
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EDITED BY AMY DUNKIN

Investing

WHY MUNIS COULD LIFT YOUR BOND MARKET BLUES

Rising interest rates have hammered fixed-income markets repeatedly this year and may continue to do so for the next few months. But if you aren't spooked by the decline and can handle some volatility, you will find some compelling reasons to buy municipal bonds.

First, yields on long-term munis currently equal about 80% of the yields on taxable Treasury securities. That means anyone above the 15% bracket is better served in tax-frees. If you are subject to state income tax you can get double tax-exemption by buying your state's bonds. For people with a marginal tax rate of 40%, the aftertax yield on a 20-year bond is about 10%. "That's about the same or a little greater than the

average annual total return on the Dow Jones industrial average for the last 65 years—without the risk," says Robert Goodman, chief economist for Putnam Investments.

Add low inflation to the equation, and munis are looking even better. Tax-free yields are now around 6.5% for high-grade, long-term munis maturing in 20 years or more. Subtract this year's 2.7% increase in the consumer price index and you're getting nearly a 4% real return. "These real rates are higher than they were in 1981, when you had market yields of 14% and 15% on tax-free bonds and inflation of 12% or 13%," says Goodman.

That 4% real yield is an anomaly. So if inflation stays moderate, muni yields should

drop—as much as a full percentage point, predicts Jay Chitnis, a bond dealer at Stoeber Glass in New York. Then, people who hold today's high-yielding bonds will see them surge in price.

All these pluses are buoyed by the fact that the muni-bond supply has fallen off dramatically since February. In 1993, municipalities rushed to refinance and issued a record \$300 million in bonds. So far this year, new munis are being floated at a rate 60% lower than last year, says Joseph Deane, portfolio manager of Smith Barney Shearson Managed Municipals Fund. That will give municipal bonds some downside protection if rates continue to rise in the short term. And, he says, "I expect demand to continue to

outpace supply for tax-exempts—a situation that offers investors significant upside price appreciation relative to taxable securities."

"NORTH OF BULLISH." The arguments for buying munis are largely based on long-term trends. But the bond market has been trading more cautiously on the economic news of the day. Deane, who describes himself as "a little bit north of bullish" on municipals, thinks the time to invest is now. Even though the Federal Reserve Board is expected to raise short-term rates for the sixth time this year, he says, "an additional hike—and all the other negative news about bonds—has largely been factored into prices. Since few people are expecting good news, he says, "a major mo-

going to be down, it's
to be up."

of the nice things
buying muni bonds is
as long as you plan to
them until maturity, you
need to worry about
rate movements and
fluctuations. Convention-
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"California paper, rela-
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oks very cheap," says
Some hospitals and
homes in areas where
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by buying lower-rated
or there's a chance you
need access to the mon-
should diversify across
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minimum tax.
municipal bonds
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s industrial-devel-
t revenue bonds
often are.

Be sure to shop around for
the best price. Bond dealers
and brokers do not make
their money by commission
but by marking up the price
of the security. Markups can
vary from 1% to 4% and tend
to be lower when you buy di-
rectly from a bond dealer's
own inventory rather than
from a stockbroker, who usu-
ally will go to a dealer to find
the bond you want. If you

cording to IBC/Donoghue) for
someone in the 39.6% bracket
has a tax-equivalent yield of
4.47%. The average taxable
money-market fund yields
4.26%.

You will get the most value
if you buy bonds that mature
in 10 to 15 years. But keep
in mind that the longer the
maturity, the more interest-
rate risk you take on—and the
more likely your circumstanc-

individuals deciding to pick
their own securities.

"People are going through
a whole reevaluation of munic-
ipal-bond funds," says Isaac-
son, who puts most of his cli-
ents in individual bonds. While
the drop in total returns of
3.92% this year has not been
that major, the decline in prin-
cipal, or net asset value, has
been severe: 7.38%, says the
Bond Fund Report. "People will

MUNI FUNDS VS. INDIVIDUAL BONDS

Maturity (yrs.)*	Fund	Current yield	AAA noncallable bond	Yield **
2.5	Vanguard Municipal Limited Term	4.26%	Sacramento, Prerefunded (6.625%, 2/1/97)	4.7%
10.0	Dreyfus Intermediate Municipal Bond	5.22	Longview, Tex. CGIC Insured (6.35%, 3/1/04)	5.5
10.0	Fidelity Spartan New York Intermediate Municipal Bond	5.29	New York State, FGIC Insured (5.55%, 8/15/04)	5.5
20.0	Fidelity Municipal Bond	5.73	Pittsburgh, FGIC Insured (7.25%, 9/1/14)	6.1

*Average weighted

DATA: STOEYER GLASS & CO.

**At maturity

have to sell the bond, you'll
get clipped again.

If you have a short-term
horizon and aren't in the high-
est tax bracket, make sure
you belong in tax-frees. "At
two to three years, it may be
better to be in Treasuries,"
says Joel Isaacson, a New
York financial planner. To
compare how you would fare
in taxable vs. tax-exempt se-
curities, subtract your tax
bracket from 1 and divide
that into the tax-exempt yield
times 100. Using this formula,
2.70% (the average for all tax-
free money-market funds, ac-

es could change, perhaps forc-
ing you to cash in your bonds.
If you want securities that
mature in more than 10 to 12
years, invest in a mutual
fund, Deane recommends.
Aside from professional man-
agement and diversification,
mutual funds offer ease of en-
try and exit. If you don't need
to spend the income, they also
simplify reinvesting.

RATING GAME. The case for
buying individual securities in-
stead of mutual funds gets
more compelling in a rising
rate environment. Bond-fund
yields have a tendency to lag
behind interest-rate
movements, which gives
them an advantage
when rates are falling
but makes individual
new issues look more
tempting when rates are
going up. As a result,
cash flow into tax-free
funds has slowed sub-
stantially. At the end of
1993, there was \$201 bil-
lion in municipal-bond
funds, vs. \$187 billion to-
day, according to
IBC/Donoghue's *Bond
Fund Report*. Deane sug-
gests the problem is not
less demand but more

say: "Why should I buy your
fund, which is yielding 6.5%,
when I can get an AAA-bond
for 6.5%?" says Allegrini.

In addition to the conven-
ience, the answer is that a
savvy fund manager can min-
imize losses. "With a managed
fund, you don't just have to
play offense, you can play de-
fense," says Deane, who has
limited his fund's losses for
the year to 0.42%. Last Octo-
ber, when he thought the
bond market was looking
much too expensive, he
brought the average matur-
ity of his fund down from
about 27 years to 15. He
brought his cash position up
to 10% and began using fu-
tures to hedge. Today, he's
holding no cash, has moved
the average maturity back up
to 22 years, and doesn't have
any hedges in place.

Whether you want to put
the extra effort into purchas-
ing individual securities or
choose a mutual fund, munic-
ipal bonds are emerging as
the best choice among fixed-
income investments. Keep
your eye on them, even
if you choose to wait until
the market gets a little less
wild.

Amey Stone

A MUNICIPAL-BOND BUYING STRATEGY

- ▶ Unless you plan to hold bonds to maturity, diversify across 5 to 10 issues.
- ▶ Stick with AAA-rated issues or even safer "prerefunded" or "escrowed" bonds so you don't have to worry about credit risk.
- ▶ Make sure there are no hidden bond call provisions.
- ▶ Comparison shop. You will usually get better prices from a bond dealer than from a stockbroker.

DATA: BUSINESS WEEK

Mortgages

ARE THESE LOANS WORTH THE MONEY?

The article, "Make Money on Your Mortgage," (Personal Business, Aug. 29) on a new Fannie Mae-approved product, the asset-integrated mortgage (AIM), raised so much reader interest that the subject begged a revisit. Most people questioned the validity of a product that requires borrowers to get a larger 30-year loan at 8.5% while putting part of the downpayment in a tax-deferred annuity, currently earning 6.2%. (Our example assumed the purchase of a \$100,000 home with a \$20,000 downpayment and an \$80,000 mortgage. Using the AIM alternative, the home buyer

would put down \$5,000 on the house and \$15,000 in the annuity, so the loan would be \$95,000.) A few readers questioned the tax consequences of the AIM. CPA Mark Kersting, a tax principal at Urbach, Kahn & Werlin New York, helped us formulate our responses to the following questions.

Aren't there better ways to invest the difference between the \$615 monthly payments on the conventional loan and the \$730 on the AIM?

If you have the discipline to invest the difference every month—and for many people, that's a big if—there are better investment options, such as paying off the mortgage early. But if you're likely to fritter away that money, the AIM lets you divert part of your downpayment into a relatively safe, tax-deferred savings vehicle, which guarantees your principal and a market interest rate. It also diversifies your investment, so you

can offset any loss in your home's value.

How can you borrow at 8.5%, invest at 6.2%, and save?

By calculating the annual mortgage-interest deductions and the effects of tax-deferred compounding on the annuity, you will save money after 30 years. That's because the compounding becomes more

will be greater after so many years, but you will have more for it. Sometime a 10 to 15 years, you start come out ahead.

An important point missed was that the AIM can be reset periodically, a floor rate of 3.5% to You can sign a contract adjusts every year or up every 10 years. Your rate reflects prevailing interest rates.

If you liquidate the annuity before age 59½, will you have to pay a 10% penalty plus income tax on the interest?

Yes, except if the owner dies or is disabled, the proceeds are transferred to another annuity, or are paid over at least five years.

Since the annuity is collateral, is the interest taxable before you cash it in?

No. With the AIM, you pledge only the principal. The entire annuity were collateral, the interest would be taxed. Pam B...

Clearing up the fine points of asset-integrated mortgages

valuable with time. You will have to pay taxes on the annuity interest, but that only slightly offsets the gain. However, the AIM doesn't look as good after seven years, the average time people own a house. Your cash payout will be less, but you will also owe more than on a conventional mortgage. The equity, too,

For people who work out of their homes, trying to get proper insurance can be frustrating. Homeowner policies don't pick up most losses on business equipment or liability if someone gets hurt in your office. And many of the separate home-office policies insurers began offering five years ago don't have realistic coverage limits.

Now, insurers are seeking to correct the inadequacies. The changes initiated by Aetna Life & Casualty, for example, result in part from a survey that found that many home-based business owners mistakenly "assume their homeowner policy covers everything they need," says Robert Restrepo Jr., Aetna's vice-president for homeowner insurance.

Aetna and its competitors are also looking to expand their home-office business to compensate for all the homeowner's customers they have

PUTTING MORE TEETH IN YOUR HOME-OFFICE COVERAGE

dropped in areas hit by earthquakes, floods, and hurricanes.

Aetna's revised coverage increases protection for business-related assets and liability. Aetna used

phones. Now it will hike each of the limits to \$2,500 in a new home-office rider to its standard homeowner policy that it plans to introduce in October.

In addition to business-related injuries, the rider covers product and advertising liability for up to \$300,000. But it excludes professional liability for doctors, lawyers, accountants, and even insurance agents. Annual premiums run about 25% higher than those for the old coverage with the lower limits. The package, including replacement cost for a \$200,000 house, for example, will go for about \$500 a year, with the home-office rider accounting for nearly half the total.



to pay a maximum of only \$200 for cash losses and \$1,000 for losses from accounts receivable, stolen credit cards, and cellular

In response to Aetna's move, ITT Hartford Group also considering increasing coverage limits for home offices. It now reimburses losses of \$200 in cash, \$500 from credit cards, and \$1,000 from accounts receivable. For larger home-based operations, Continental is offering a separate \$175-a-year home-office policy that covers up to \$5,000 loss from stolen cash, \$5,000 from stolen credit cards, and \$10,000 from accounts receivable, as well as \$500,000 in liability.

UMBRELLAS. If the liability limits on your home-office insurance are not high enough to cover your needs, an umbrella policy can provide extra protection, says Seamus Mooney, an economist with the Insurance Information Institute. It will pay for losses that go beyond the thresholds of the original policy. But keep in mind that an umbrella insurance added on to a homeowner policy will cover business liability only if it's also covered by the base policy. Chris Rou...

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Electronics

AUDIOPHILES REDISCOVER AN OLD FRIEND

The more things change, the saying goes, the more they stay the same. So it is in the world of high-end audio. After a decade in which enthusiasts spent ever larger sums of money on more powerful solid-state amplifiers, audiophiles are rediscovering the joy and simplicity of a device from a bygone age—the vacuum tube.

Given up for dead when transistors came on the scene in the 1960s, the quirky tube is once again being prized for its sonic virtues. Indeed, manufacturers of some of the leading solid-state brands, such as Threshold and Conrad-Johnson, are promoting their products' tube-like sound—one that is more lush, or romantic, than the crystalline tone of a transistorized device.

MONDO RETRO. Ironically, the tube renaissance began several years ago in Asia, home to the mass-market audio equipment that displaced many of the tube-dominated American components. Japanese stereophiles have been ardent buyers of such antique tube amps as the Marantz 9, driving the price up to \$10,000—more than 12 times its original cost.

In the U.S., a cottage industry of amplifier makers such as Cary Audio and Valve Amplification Co. has sprung

up in recent years to replicate tube designs dating as far back as the 1930s. Many of these amps are made from the finest quality parts hand-wired together. Another group of companies, led by Audio Research Corp., is mixing tubes and transistors in hybrid designs. Even do-it-yourselfers are dusting off their Dynacos and rebuilding them with modern parts.

Russia and China have become the leading sources of original and replacement tubes to meet the growing demand. Unlike in the U.S., the technology never died out in the former communist world—the Soviets continued to use tubes in their MiG fighter planes because they were not susceptible to radiation the way transistors are. "In the last two to three years, we've seen some higher quality tubes come onto the market," says Terry Dorn, head of marketing for Audio Research. "It has allowed manufacturers to once again explore all-tube circuit designs."

WELL-TEMPERED TONE. It may be more than coincidence that tubes are flourishing at the same time as digital audio. Some music lovers think that tubes in the amplification chain are necessary to soften the sometimes harsh sound produced by compact disk players.

GREEN HOMES. People concerned about indoor air pollution can consult *How Healthy Is The Air In Your Home?* from the Consumer Federation of America. The free brochure contains a checklist of potential pollutants and their remedies. Send a self-addressed stamped envelope to CFA IAQ Checklist, P.O. Box 12099, Washington, D.C. 20005-0999.

Worth Noting

FAULTY ADVICE. You can't always rely on tax advice from Uncle Sam. The Research Institute of America reports that when IRS representatives mispeak, the letter of the Tax Code still stands. Moreover, courts have ruled that the IRS isn't even bound by the text used in its own publications.



SOME MODERN TUBE COMPONENTS

PREAMPLIFIERS

AUDIO RESEARCH LS7 Minimalist, all-tube design. \$1,395

JADIS JPL Stylish, French-made unit for CD replay only. \$5,395

AMPLIFIERS

QUICKSILVER GLA-75 Starter amp. \$1,195

McINTOSH MC275 Remake of a 30-year-old classic from company that is audio equivalent of Harley Davidson. \$4,000

CD PLAYERS/CONVERTERS

CARY 955 All-in-one tube design based on chassis of Rotel 955 CD player. \$700

VAC DAC Digital processor that uses tubes and has separate power supply for better sound. \$4,490

DATA BUSINESS WEEK

BEAUTIFUL OBJECT, LUSH SOUND: MOVE OVER, TRANSISTOR

By contrast, today's id-state amps are imposing gray with huge fans to dissipate heat in the "Very often a tube is an object of aesthetic beauty," Sam Tellig, contributor at *Stereo* magazine.

MINT EDITIONS. Beauty comes at a price. The best gear costs a small fortune, though no more than exotic transistor units. It is not uncommon to pay \$4,000 up for a quality tube. The esoteric Japanese-made Ongaku tube from Audio Note for \$65,000, a more akin to a star house. More models appear. For example, Cary subsidiary, A Electronic Supply, kets a tube amp kit \$700 and the same (Model SE-1) preamplifier for \$1,000. Quickver Audio has the (Great Little A which sells for \$1,195.

There are several drawbacks. Tube equipment can be finicky, unsuited to speakers that need a lot of power to drive them. The tubes themselves need replacing every couple of years depending on use. And the same open-ended design that makes them appealing to audiophiles is a lure to the prying fingers of young children.

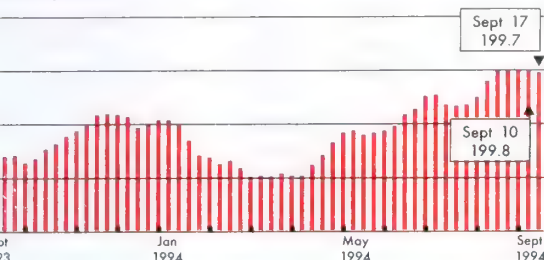
Yet the tube sound is quickly forgotten. And in 1990s, with a newfound appreciation of mellower performers such as Tony Bennett and Barbra Streisand, who could be more retro than owning a piece of stereo equipment that not only enhances their sound but looks like something on which the original records could have been heard? *Tim Sn*

Business Week Index

PRODUCTION

Change from last week: -0.1%
Change from last year: 4.1%

1967=100 (four-week moving average)

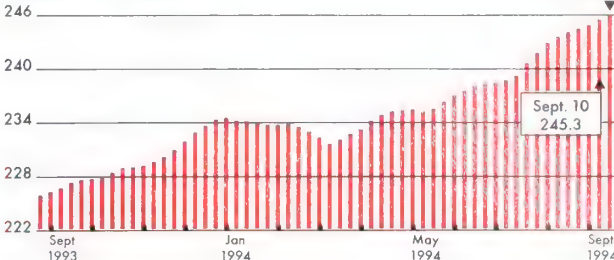


Production index was virtually unchanged during the week ended Sept. 17. Index has held steady since August. On a seasonally adjusted basis, output of steel, autos, trucks, crude-oil refining, coal, paper, lumber, and rail-freight declined. Production of electric power and paperboard increased. Before revision of the four-week moving average, the index stood at 200.2, little above its reading of 200 in the previous week.

BW production index copyright 1994 by McGraw-Hill Inc

LEADING

Change from last week: 0.2%
Change from last year: 8.2%



The leading index increased slightly during the week ended Sept. 17. Faster growth rates for real estate loans and materials prices mostly offset the decline in stock prices and higher bond yields. M2 growth was unchanged from its slow growth rate of the previous week, and data for large-business failures were unavailable. Before calculation of the four-week moving average, the index rose to 246.8, from a revised 246.1 in the week ended Sept. 10.

Leading index copyright 1994 by Center for International Business Cycle Research

PRODUCTION INDICATORS

	Latest week	Week ago	% Change year ago
STEEL (9/24) thousands of net tons	1,870	1,737#	3.7
TRUCKS (9/24) units	137,982	132,270#	18.1
TRUCKS (9/24) units	115,951	119,270#	11.3
ELECTRIC POWER (9/24) millions of kilowatt-hours	59,427	63,823#	1.6
CRUDE OIL REFINING (9/24) thousands of bbl./day	14,034	14,066#	1.1
COAL (9/17) thousands of net tons	19,989#	19,095	3.0
WOOD (9/17) thousands of tons	896.5#	876.8r	7.8
PAPER (9/17) thousands of tons	811.0#	822.0r	0.4
RAIL FREIGHT (9/17) millions of ft.	500.6#	398.5	3.7
TRUCKS (9/17) billions of ton-miles	24.3#	22.0	5.7

American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, Petroleum Institute, Energy Dept., American Paper Institute, WWSA¹, SFPA², Association of Railroads

FOREIGN EXCHANGE

	Latest week	Week ago	Year ago
YEN (9/28)	99	98	106
MARK (9/28)	1.55	1.55	1.64
POUND (9/28)	1.58	1.58	1.49
FRANC (9/28)	5.28	5.29	5.72
DOLLAR (9/28)	1.34	1.34	1.33
FRANC (9/28)	1.28	1.28	1.43
PESO (9/28) ³	3.388	3.401	3.117

Major New York banks. Currencies expressed in units per U.S. dollar, except for British pounds expressed in dollars

COMMODITIES

	Latest week	Week ago	% Change year ago
WHEAT (9/28) \$/troy oz.	396.250	394.900	12.2
WHEAT (9/27) #1 heavy, \$/ton	134.50	134.50	19.6
FFS (9/26) index, 1967=100	212.0	211.5	0.2
WHEAT (9/24) ¢/lb.	127.3	124.5	46.4
WHEAT (9/24) ¢/lb.	79.0	77.5	52.7
WHEAT (9/24) #2 hard, \$/bu.	4.08	4.04	25.5
WHEAT (9/24) strict low middling 1-1/16 in., ¢/lb.	70.56	72.78	25.9

London Wednesday final setting, Chicago market, Knight-Ridder Commodity Research, Kansas City market, Memphis market

1=In the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment. 2=Wood Products Assn. 3=Southern Forest Products Assn. #=Free market value NA=Not available r=revised NM=Not meaningful

LEADING INDICATORS

	Latest week	Week ago	% Change year ago
STOCK PRICES (9/23) S&P 500	463.32	469.70	1.6
CORPORATE BOND YIELD, Aaa (9/23)	8.41%	8.32%	23.9
INDUSTRIAL MATERIALS PRICES (9/23)	107.9	107.6	14.3
BUSINESS FAILURES (9/16)	NA	304	NA
REAL ESTATE LOANS (9/14) billions	\$440.7	\$439.2	6.1
MONEY SUPPLY, M2 (9/12) billions	\$3,560.6	\$3,559.4r	1.7
INITIAL CLAIMS, UNEMPLOYMENT (9/10) thous.	327	330	0.9

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of large companies), Federal Reserve, Labor Dept. CIBC seasonally adjusts data on business failures and real estate loans

MONTHLY ECONOMIC INDICATORS

	Latest month	Month ago	% Change year ago
ORDERS FOR DURABLE GOODS: MFG. (Aug.) billions	\$154.0	\$145.2r	16.9
EXISTING HOME SALES (Aug.) millions	3.90	3.97	1.0
BUDGET SURPLUS OR DEFICIT (-) (Aug.) millions	-\$24,174	-\$33,198	NM
CONSUMER CONFIDENCE INDEX (Sept.)	88.4	90.4	49.1

Sources: Commerce Dept., National Assn. of Realtors, Treasury Dept., Conference Board

MONETARY INDICATORS

	Latest week	Week ago	% Change year ago
MONEY SUPPLY, M1 (9/12)	\$1,152.2	\$1,155.7r	4.5
BANKS' BUSINESS LOANS (9/14)	300.4	299.4r	9.3
FREE RESERVES (9/14)	474r	501r	1336.4
NONFINANCIAL COMMERCIAL PAPER (9/21)	148.3	148.9	-8.9

Sources: Federal Reserve (in billions, except for free reserves, which are expressed for a two-week period in millions)

MONEY MARKET RATES

	Latest week	Week ago	Year ago
FEDERAL FUNDS (9/27)	4.29%	4.70%	3.05%
PRIME (9/28)	7.75	7.75	6.00
COMMERCIAL PAPER 3-MONTH (9/27)	5.18	5.01	3.18
CERTIFICATES OF DEPOSIT 3-MONTH (9/28)	5.16	5.04	3.16
EURODOLLAR 3-MONTH (9/23)	5.01	4.94	3.06

Sources: Federal Reserve, First Boston

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

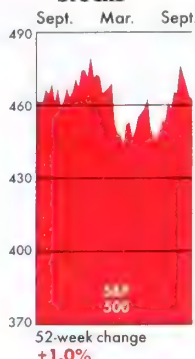
A	D	J	Q
AdvaCare 104	Dairy Mart 108	Jackmont Entermidia 116	Quicksilver Audio 1
Aetna 132	Dana 124	K	R
American Airlines 43	D. Blech 6	Kimberly-Clark 84	Regional Financial Associates 30
American Cyanamid 88	Dean Witter Reynolds 30	Kleinwort Benson Securities 30	Reliance Electric 12
American Home Products 88	DHL Air Express 50	Kohlberg Kravis Roberts 106	Richfood Holdings 8
American International Group 52	Dime Savings Bank 44	L	RJR Nabisco 106
Ameritech 116	DuPont 38	L&F Products 52	Robert Plan 52
Amoco 108	Duracell International 88	Ladenburg Thalmann 104	Rowland 88
A+H International 128	E	Lehman Brothers 52	S
Andrew Lanyi 104	Eastman Kodak 52, 88	LENS 106	Salmon Brothers 38
Apache 48	Emerson Electric 124	LensCrafters 104	San Diego Padres 6
Apple Computer 22	Energry 88	Lever Brothers 84	Sandoz 46
Arizona Public Service 8	E Source 124	Lexington Strategic Investments Fund 100	Sanford C. Bernstein 36
AT&T 22, 43, 52	Exxon 124	Little Caesar 108	Sears 104
Audio Note Ongaku 134	F	Lotus Development 52	Sky Chefs 38
Audio Research 134	Federated Department Stores 96	M	Smith Barney Shears
B	Fidelity Capital & Income Fund 96	Macy (R.H.) 96	Smith Barney Shears Managed Municipal Fund 130
Bank of New York 104	Fidelity Insight Fund 96	Major League Baseball 26	Sony 22 83
Black Entertainment Television 116	Fidelity Investments 88	Maybelline 46	Standard & Poor's 10
Boeing 38	Fidelity New Markets Income Fund 96, 100	MCA 50	State Farm Insurance 9
Borden 106	Fidelity Spartan Long-Term Government Bond 96	McDonald's 104	Stoeber Glass 130
Borton, Petrini & Conron 50	Fleet Financial Group 104	McDonnell Douglas 52	Strategic Insight 88
British Petroleum 108	Ford 18, 42, 124	McGraw-Hill 36	Subway 108
C	Franklin Resources 96	Medaphis 104	Sun Microsystems 6
California Angels 6	Frost & Sullivan 124	Mercer Management Consulting 116	Sundstrand 52
Canadian Imperial Bank of Commerce 66	G	MESA 48	T
Canon 124	Gap 52	Microprobe 6	Taco Bell 108
Capstone Nikko Japan Fund 100	GE 38, 124	Minnesota Twins 6	Texas Instruments 38
Catamount Auto Parts 8	General Magic 22	Mitchell Energy & Development 48	Thinking Machines 6
Catamount Brewing 8	Gerber Products 46	Morgan Stanley 52	Threshold 134
Catamount Landscaping 8	GM 18, 42	Morningstar 88, 100, 130	Time Warner 52, 116
CGM 88	Goldman Sachs 46, 106	Motorola 22, 88, 128	Tocqueville Asset Management 106
Cherry 88	H	N	Toshiba 52
Chrysler 18, 42	Harris 128	National PCS Consortium 116	Toyota 18
Circle K 108	HealthNet 50	NatWest Securities 48, 52	TRI 128
Citibank 6	Hewlett-Packard 124	NBC 52	T. Rowe Price 106
Citicorp 44	HNB Investment 108	NEC Technologies 22	Twentieth Century Investors 88
CNN 6	Home Depot 114	Nesbitt Burns Economics 66	U
Coca-Cola 8, 114	Honda 18	NFL 26	Urbach, Kahn & Werlin 132
Colgate-Palmolive 84	Houlihan Lokey Howard & Zukin 6	Nine West Group 104	U.S. Shoe 104
Collins & Aikman 46	I	Nova 66	V
Community Bankers U.S. Government Money-Market Fund 52	IBC/Donoghue 130	Nynex 52	Valve Amplification 13
ConAgra 106	IBM 44, 52	O	Vanguard Group 96
Concert Productions International 83	ImClone Systems 6	Oakland Athletics 6	Vision Express 104
Conrad-Johnson 134	Information Resources 84	Oracle 52	Volkswagen 18
CS First Boston 30, 84	ITT Hartford 132	P	W
	Ixion Biotechnology 128	PaineWebber 48	Wasserstein Perella 46
		Paramount Pictures 50	Wertheim Schroeder 4
		Park Scientific 128	Westinghouse 6, 44
		Philip Morris 44, 108	Wilen Management 10
		Pittsburgh Pirates 6	Y
		Prater & Gamble 8, 58, 84	Yackman Asset Management 106
		Prudential Municipal Bond-High Yield Series 130	Z
		Putnam Investments 130	Zenith Electronics 44

Investment Figures of the Week

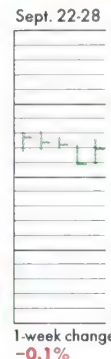
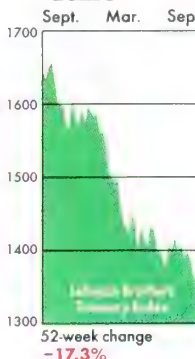
TARY

breathed a sigh of relief
ederal Reserve decided
and not raise short-term
es. While rate hikes lat-
remain a possibility,
markets seem satisfied.
ek, stocks made small
ss a wide variety of sec-
company stocks gener-
he best. Beaten-down
es were among the hot
with the S&P utility in-
%. That suggests invest-
ink the interest-rate run-
out over.

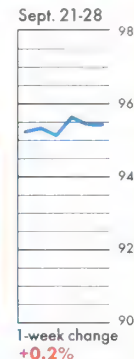
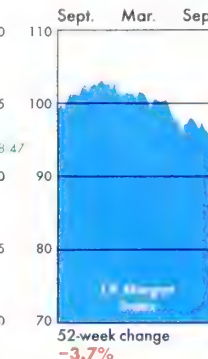
STOCKS



BONDS



THE DOLLAR



MARKET ANALYSIS

STOCKS	Latest	% change Week	% change 52-week
INDUSTRIALS	3878.2	0.7	8.7
COMPANIES (S&P MidCap Index)	174.5	0.4	-0.7
COMPANIES (Russell 2000)	254.4	0.0	1.1
COMPANIES (Russell 3000)	267.4	0.6	0.0

STOCKS	Latest	% change (local currency) Week	% change 52-week
FINANCIAL TIMES 100	3038.7	0.8	0.3
NIKKEI INDEX	19,507.6	-1.9	-2.8
DAX COMPOSITE	4372.5	0.3	9.8

FUNDAMENTALS

	Latest	Week ago	Year ago
90-DAY TREASURY BILL YIELD	4.60%	4.91%	2.99%
30-YEAR TREASURY BOND YIELD	7.81%	7.80%	6.00%
S&P 500 DIVIDEND YIELD	2.74%	2.75%	2.71%
S&P 500 PRICE/EARNINGS RATIO	18.3	18.3	23.8

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 26-week moving average	460.9	461.0	Positive
Stocks above 26-week moving average	36.0%	37.0%	Positive
Speculative sentiment: Put/call ratio	0.44	0.41	Positive
Insider sentiment: Vickers sell/buy ratio	1.42	1.17	Positive

INDUSTRY GROUPS

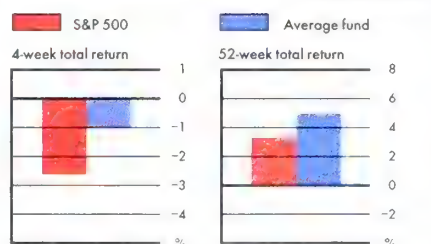
INDUSTRY LEADERS	% change 1-month	% change 12-month	Strongest stock in group	% change 1-month	% change 12-month	Price
MINING	21.9	23.5	AMERICAN BARRICK	27.5	16.6	27 1/4
MINING	6.5	52.2	ASARCO	15.1	95.0	34 3/8
MINING	5.9	30.7	REYNOLDS METALS	10.7	28.5	56 7/8
MINING	5.8	NA	EASTMAN KODAK	6.3	13.1	52 1/2
MINING	4.0	23.8	JAMES RIVER	13.8	8.6	23 3/4

INDUSTRY LAGGARDS	% change 1-month	% change 12-month	Weakest stock in group	% change 1-month	% change 12-month	Price
APPAREL RETAILERS	-13.6	-14.2	GAP	-28.7	4.6	31 1/8
APPAREL RETAILERS	-12.6	-24.6	USAIR GROUP	-26.4	-60.6	4 7/8
CONSTRUCTION	-10.8	6.3	FOSTER WHEELER	-14.7	5.0	34
TRANSPORTATION SERVICES	-8.8	2.4	FEDERAL EXPRESS	-11.8	-1.0	61 1/8
TIME	-8.6	18.4	BRUNSWICK	-13.1	34.8	19 7/8

MUTUAL FUNDS

LAGGARDS	Four-week total return	%
STEADMAN OCEANOGRAPHIC TECHNOLOGY	-8.5	
FIDELITY SELECT AIR TRANSPORTATION	-7.6	
ALLIANCE PREMIER GROWTH C	-6.6	

LAGGARDS	52-week total return	%
MONITREND GOLD	-35.6	
STEADMAN OCEANOGRAPHIC TECHNOLOGY	-35.1	
STEADMAN INVESTMENT	-25.9	



RELATIVE PORTFOLIOS

Accounts	the present	10,000	one year ago	portfolio	es indicate	total returns
Foreign stocks	\$11,515	-0.06%				
Gold	\$11,134	+0.48%				
U.S. stocks	\$10,295	-0.28%				
Money market fund	\$10,205	+0.05%				
Treasury bonds	\$8,944	-0.74%				

is page as of market close Wednesday, Sept. 28, 1994, unless otherwise indicated.
ps include S&P 500 companies only; performance and share prices are as of market close

Sept. 27. Mutual fund returns are as of Sept. 23. Relative portfolios are valued as of Sept. 27. A more
detailed explanation of this page is available on request. NA=Not available r=revised

WHY CLINTON HAS BUSINESS FUMING

The facts are very clear. Since Bill Clinton became President, the economy has been strong, inflation has been low, exports have jumped, the budget deficit has been cut, and the federal bureaucracy has been trimmed back.

Yet, as the BUSINESS WEEK/Harris Poll on page 38 shows, the business community basically hates the Clinton Administration. The President gets little credit for any achievements—from expanding free trade to generating jobs. Why?

Part of the reason, of course, is the character factor. The continuous drip-drip of events involving questionable ethics—from dissembling over the draft to Whitewater, have taken their toll.

Then, there's the Clinton social agenda that irritates the hell out of businesspeople. The big-government-eats-one-seventh-of-the-economy-health-care plan has cost Clinton dearly within the business community. Even Clinton's early Big Business support for health-care reform was trashed by his shift away from cost control to universal coverage. Now, business is suspiciously eyeing the Administration's step-up in regulation, particularly in civil rights, health and safety, and banking.

In the end, it may well be the President's managerial style that most infuriates business. The procrastination followed by improvisation, the vacillation, the immense sloppiness in decision-making are anathema in the business world. People living in a culture of efficiency, continuously making them-

selves and their institutions more competitive, are more appalled by Clinton. They are filled with disdain.

Ironically, business has done remarkably well under Clinton Administration. While Clinton has been in office, corporate profits as a share of national income have soared 9.6%, compared with 8.5% under President Bush and 8.1% under President Reagan. Although corporate CEOs and managers have personally seen their incomes drop because of higher taxes, their companies are faring better than any since the 1970s.

President Clinton has two years to go before he faces the next Presidential election. It may be too late to get much respect from the business community, but the President must take a number of steps to at least neutralize some of the negatives. A return to his New Democratic centrist politics would be a beginning. That would mean reining in his pro-regulation minions throughout the federal bureaucracy. Passing significant welfare reform would also help. The most serious step, of course, would be to tackle the runaway government spending that continues to chip away at the nation's economic health.

That would still leave the Clinton style, a miasma that Leon Panetta hasn't been able to clear. Leadership requires discipline and the exercise of power. If President Clinton learns these skills, he might win some support, even from the skeptical business community.

THE REAL HERO OF RUSSIA'S TURNAROUND

What a difference a year makes in Russia! Just nine months ago, its economy was in tatters, inflation was raging, and the radical reformers had been soundly defeated and ousted from government. Today, the economy is growing, inflation is way down, and a new class of entrepreneurs is spearheading the drive toward a competitive market economy (page 68).

After a four-day summit meeting with Russian President Boris Yeltsin, President Clinton should realize that the man responsible for Russia's surprising progress is not Yeltsin but Prime Minister Viktor Chernomyrdin.

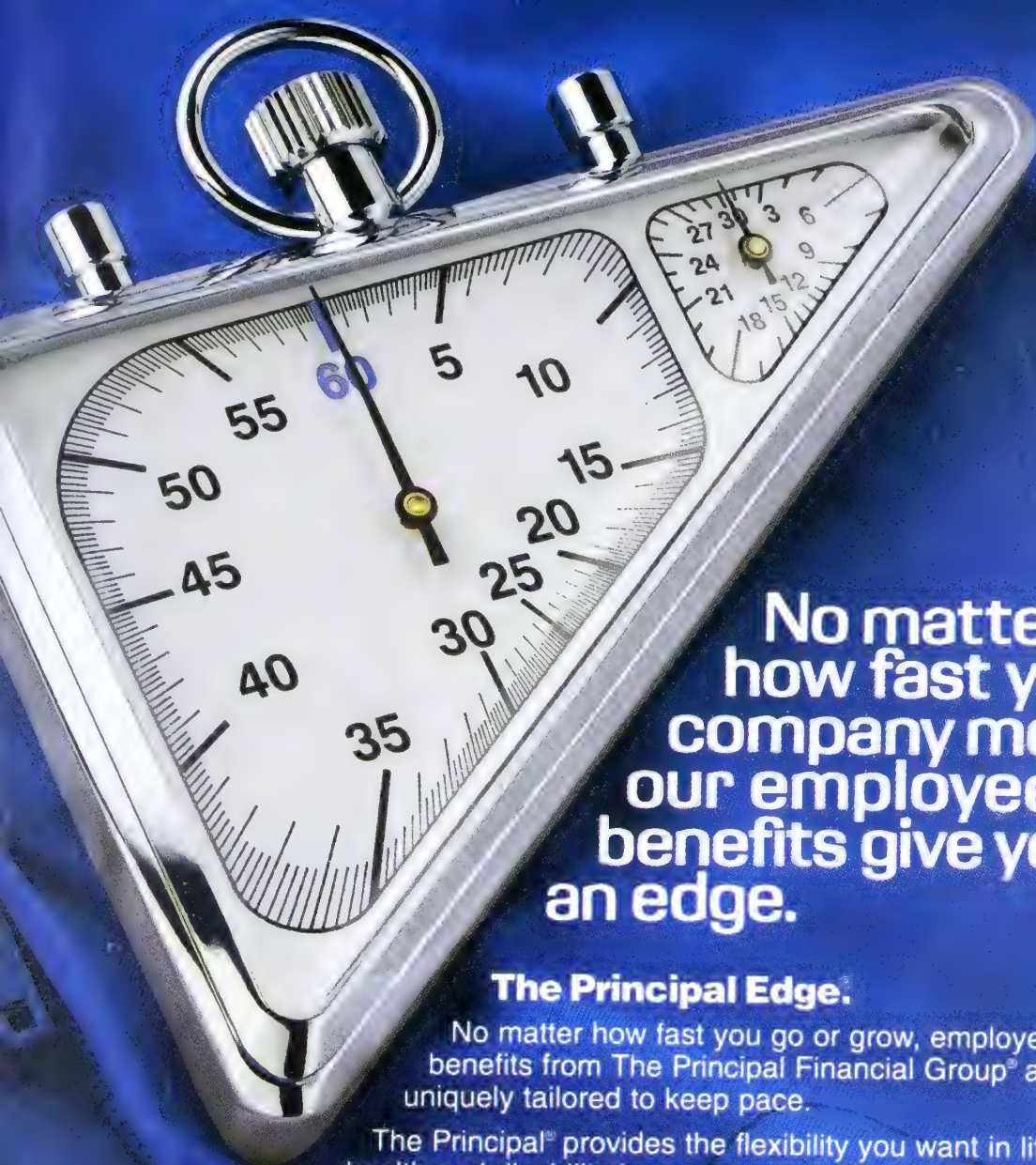
In its first year, the Clinton Administration's Russia policy, designed by Deputy Secretary of State Strobe Talbott, focused totally on supporting one man—Yeltsin—and his small band of "shock-therapy" market radicals led by Yegor T. Gaidar. Their policy was to gut the state-owned sector and shut down all of the country's big industrial enterprises. Opponents of this strategy were perceived as antimarket statisticians. When the radicals were booted from the government, the White House was bereft and expected chaos in Russia.

It never happened. Chernomyrdin came in and found the right formula for privatizing without deindustrializing. Building from his centrist position as onetime czar of Russia's huge

energy industry, he was able to enforce the reformers' monetary and fiscal programs while not threatening the military-industrial complex. By retaining his country's large enterprises and working to make them more efficient, Chernomyrdin held out hope that Russia could again become a global power. It was a brilliant strategy.

Billions of dollars from American and European hedge funds and merchant banks are now flowing into new Russian securities. Institutions and individuals are beginning to bet big on the new Russian capitalism. The pragmatists proved right in their approach, and Washington, following the footsteps of private investors, should recognize this.

Chernomyrdin's government still has a lot of work to do—cutting red tape, curtailing taxes, codifying commercial law, and battling criminals. But it has already earned the economic respect of the West. The Administration can help by championing Russia's entry into the General Agreement on Tariffs & Trade, pushing the International Monetary Fund to deliver on \$8 billion in promised loans, and making \$6 billion available for a currency-stabilization fund that pegs the ruble and makes it convertible. When it comes to economic reform, it's time President Clinton began talking to Prime Minister Chernomyrdin.



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BusinessWeek

ER 17, 1994

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A NEW LOOK FOR A NEW ERA

Sept. 7, 1929. Herbert Hoover was President. Babe Ruth had just hit his 46th home run of the year. And the Roaring Twenties were about to end in a market crash and the Great Depression. On that day 65 years ago, the first issue of a magazine called *The Business Week* was published. Hardly an auspicious time to start a business magazine. But since then, *BUSINESS WEEK* has become the world's largest business magazine, with a global circulation of more than 1 million copies every week. Earlier this year we were proud to receive the highest honor a magazine can win: The National Magazine Award for General Excellence. If anything, the future seems even brighter than our illustrious past. An exciting new global era is dawning for business, a time when communism is being replaced by capitalism, when Third World countries are embracing market economics, and when America itself is well into a new epoch—the Information Age. Rarely has the world offered so many opportunities for business as now.

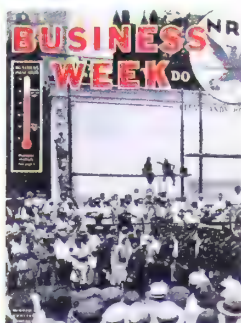
GLOBAL FOCUS. At age 65, many people start receiving Social Security benefits, put up their feet, and relax a bit. At *BUSINESS WEEK*, 65 is a time for us to kick our heels and experience a metaphoric rebirth.

As a symbol of the future, we have chosen this anniversary issue to launch a redesign—our first since 1983. It's not the radical overhaul we felt was necessary then, but an elegant refinement of that pioneering change. We're unveiling a classic new logo, changing our table of contents page, improving our display language, and sprucing up the graphics. We believe we are adding more style to the valuable substance we have long sought to provide. Art Director Malcolm Frouman worked with independent designer Molly Leach to create the new look, while Production Manager Richard Balestrino took on the complex task of adapting the design for our desktop production system.

THE DESIGN EVOLUTION



Sept. 7, 1929



Aug. 12, 1933



May 2, 1959



Aug. 24, 1974



Apr. 25, 1983



Oct. 17, 1994

The changes are more than skin-deep. We are expanding international coverage by about 25% in our U.S. edition—to give readers the information they need to compete in the global economy. While other magazines are cutting international coverage, we have strengthened our reporting staff around the world, already far and away the largest of any business magazine. And our international edition has been customized for readers outside North America. This material will also be available for our foreign-language editions in China, Russia, and Poland.

INSTANT ACCESS. In the past few months, we have added other new features, including our lively Up Front section and our Technology & You column. Next month we will publish a groundbreaking bonus issue on 21st-century capitalism, an in-depth look at the emerging global economy—from management and technology to finance and marketing.

As the Information Revolution proceeds, *BUSINESS WEEK* will offer its distinctive brand of journalism in a variety of new ways—from CD-ROMs to on-line delivery. Starting in December, the entire content of the U.S. and international editions of *BUSINESS WEEK* will be available weekly on America Online. For information, please call 800 641-4848.

For this 65th anniversary issue, we are publishing a 34-page Special Report on the changing world of work (page 74). The twin forces of technology and globalization are rapidly transforming the way we work, indeed the very notion of work. Our package of stories probes these changes and outlines future possibilities. It is this kind of perspective and insight that will never go out of style at *BUSINESS WEEK*.

We look forward to serving you for years to come.

Stephen B. Shepard
Editor-in-Chief

BusinessWeek

OCTOBER 17, 1994



Special Report

74 RETHINKING WORK

Vast changes in the economy, technology, and the workforce have altered work itself—not just in the U.S., but around the world

86 COMMENTARY

Forget schmoozing around the water cooler. Welcome to the company that isn't there

88 BUSINESS ROLLS THE DICE

U.S. companies have to take bigger gambles—for bigger winnings

92 WINDS OF CHANGE, WORLDWIDE

The global workforce will be more educated, better-trained, and smaller

94 NEW RULES OF THE GAME

Mobility, empowerment—how do the buzzwords translate day-to-day? Seven workers tell us how they're managing

106 THE WORKPLACE: A PHOTO ALBUM

Yesterday's worker wouldn't know the joint; the faces are different, too. A look at the changes, 1929-94

Top of the News

42 "RONALD REAGAN OF NEW JERSEY"

Christie Whitman's stardom has governor wannabes talking tax cuts

44 THE DEMS COME OUT SCRATCHING

Incumbents are drawing GOP blood

45 VOTER BEWARE

Local ballot initiatives' sleight of hand

46 THE U.S.-JAPAN TRADE DEAL

Why Washington backed off

48 THE STORMS ON USAIR'S RADAR

It must cut labor costs radically

50 HOW CLOSE IS NBC TO A DEAL?

Behind the Network Shuffle hoopla

52 COMMENTARY

Sports salary caps: A bad fit

56 BRACING FOR A CHIP DIP

Demand for PCs is ebbing

56 "PRECEDENT SNUFFING"

Are court rulings for sale?

58 POW! IMAGE IS A KNOCKOUT

A small fry's comic books hit big

58 RAIDERS OF THE VIDEO ARCADE

The bumper crop of game-based films

60 IN BUSINESS THIS WEEK

International Business

64 GERMANY

Global pressures finally force its industry to get into shape

68 BRITAIN

Murdoch has the last laugh—again

70 MEXICO

Reform faces murderous opposition

73 INTERNATIONAL OUTLOOK

Italy: Business backs Berlusconi

Economic Analysis

30 ECONOMIC VIEWPOINT

Dornbusch: The Latin summit

34 ECONOMIC TRENDS

39 BUSINESS OUTLOOK

Can consumers keep on spending?

172 ARGENTINA AT A CROSSROADS

Election politics could derail reform

174 A TALK WITH DOMINGO CAVALLO

"Argentines are more realistic"

Government

63 WASHINGTON OUTLOOK

The CIA's new beat: Economics

For information on reprints of this Special Report, call Business Week Reprints at 609 426-5494, or write Business Week Reprints, P.O. Box 457, Hightstown, N.J. 08520.

SPECIAL REPORT

RETHINKING WORK

The global economy has transformed the workplace, making it a realm of higher risks—and rewards
page 74



SPEED DEMON

The winning ways of Roger Penske, pit boss and chief exec
page 155

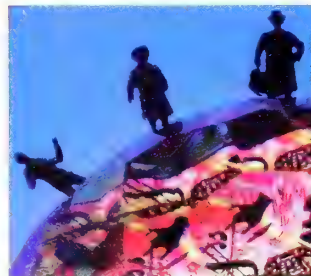


LOVE THAT GOV

New Jersey's Whitman: How to cut taxes and influence people
page 42

GETTING WIRED

A cyberspace cadet's guide to exploring a galaxy of electronic services
page 242



BLUE SKY AT NORTHWEST

CEO Dasburg, with help from his unions, has shrunk the carrier into a turnaround
page 190

ole
N THE FAST LANE
Roger Penske built his empire
al Affairs
AL SURGERY BACKLASH
ap over pedicle-screw fixation
ts Business
MENTARY
ids and sports: What price glory?

Information Processing

NOLOGY & YOU
COM REFORM: A LOCAL CALL
s deregulate on their own
WINDOW OF OPPORTUNITY
is here now. Windows 95 isn't
THE ARMCHAIR JET DESIGNER
netric's powerful PC software

Corporation

ALTITUDE RECOVERY
s are back at Northwest
ING CORPORATE BOARDS
RS rates its holdings

Science & Technology

- 204 **DRUGMAKERS FEEL THE PINCH**
Their R&D cuts may be too deep
- 212 **INFO HIGHWAY ROBBERY**
Solutions for digital larceny
- 217 **DEVELOPMENTS TO WATCH**
Seeing-eye computers, search for cures, runny noses, "dark matter"

Finance

- 218 **TWILIGHT OF A BANK BONANZA**
Selling services looked like a big winner—until banks began price wars
- 220 **REAL ESTATE REDUX**
The commercial market is back
- 224 **A MONEY-MARKET MURDER**
The prime suspect is Houston's GSC
- 230 **INSIDE WALL STREET**
Not your average energy play
Spreckels sugar: A hidden treat?
Check out AT&T's high-tech number
- 251 **INVESTMENT FIGURES OF THE WEEK**

Social Issues

- 232 **KIDS NEED A SAFETY NET, TOO**
States find day care isn't enough

Personal Business

- 242 **FINDING YOUR WAY ON LINE**
Making a cyberspace connection
Plugging in like a Wall Street pro
Earning a degree from On-Line U.
Buying by modem
Playing games with far-off foes
Getting help if you're lost in space

Features

- 3 **EDITOR'S MEMO**
- 6 **UP FRONT**
- 12 **READERS REPORT**
- 18E4 **LETTER FROM CAMEMBERT**
- 18E12 **BOOKS**
Kearns Goodwin: *No Ordinary Time*
- 249 **BUSINESS WEEK INDEX**
- 250 **INDEX TO COMPANIES**
- 252 **EDITORIALS**
Revolution in the U.S. workplace

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Up Front

EDITED BY LARRY LIGHT & JULIE TILSNER

AFTERLIVES

THE GENERAL HAS A GOLDEN TONGUE



FAT FEES: *Powell e.pounds*

COLIN POWELL IS RAKING IN megabucks as a speechmeister and author after decades of living on military pay. As Chairman of the Joint Chiefs of Staff, he earned \$110,000 yearly. Next fall, the public will read the retired gener-

al's autobiography. His advance from Random House: \$6 million. Right now, corporate audiences can catch him at the podium, for a handsome fee. He averages a speech a week at \$50,000 to \$60,000 a pop.

Recent paydays came from General Motors, Chase Manhattan, Morgan Stanley, Dean Witter, Corning, and Merrill Lynch. On Sept. 27, he also addressed a CEO conference sponsored by BUSINESS WEEK. His message is about leadership and the need for such values as hard work.

Hauling in \$3 million or more a year means quite a lifestyle change for Powell. He recently purchased a \$1 million home outside Washington. His cousin, J. Bruce Llewellyn, the chairman of Coca-Cola Bottling companies in Philadelphia and Wilmington, Del., says the general "is probably putting everything into Treasury bills until he figures out a longer-term strategy." *Owen Ullmann*

SLUGFESTS

THE DOCS VS. THE HEALTH CZAR

POOR IRA MAGAZINER. THE plan he produced as head of the Clinton Administration's health task force was widely castigated and went nowhere. Now, he's battling attempts to sock him with a contempt-of-court citation on claims that he lied in court papers.

Last year, the Association of American Physicians & Surgeons and two other groups sued, demanding that the task force open up meetings and release documents. They argue that federal panels with nongovernment members must meet in public. In a March, 1993, affidavit, Magaziner said its members were federal workers.

The doctors say he lied, contending many staffers



MAGAZINER: *Bowed, sued*

came from the health-care industry. Magaziner says the docs are counting consultants who had no control over the task force. An appeals court disagreed with him in April, 1993, though it's unclear if the ruling can be used retroactively to hang him. Magaziner declines comment, but a senior Justice Dept. official says the allegation has no merit. If the White House can't get the suit dismissed at an Oct. 13 hearing, there could be a later airing of the charge. *Susan B. Garland*

TALK SHOW "The only permanent fixtures in New York City are Grand Central Terminal and the Empire State Building."

—Philip Morris spokesman George Knox, on the tobacco giant possibly leaving the city if it passes stricter antismoking laws

HONCHOS

THIS CEO MAY HAVE TOO MUCH ON HIS PLATE

RJR AND CONAGRA? WELL, O.K. But add Borden to the RJR Nabisco mix, and the possibility of a conflict of interest for Charles "Mike" Harper intensifies. When Harper took

food giants didn't actually compete directly.

Now, however, RJR largest shareholder, the Kohlberg Kravis Roberts buyout firm, is set to acquire 80%

Borden. RJR itself would own the other 20%. ConAgra and Borden sell rival brands of cheese, tomato sauce, frozen desserts, and dessert toppings, according to Information Resources. The Healthy Choice label that Harper pioneered at ConAgra is now one of Borden's most aggressive rivals.

Harper declined comment, and a spokesman for ConAgra would say only, "If the Borden deal closes, we'll look at it." Last spring, ConAgra CEO Philip Fletcher said RJR's acquisition

CONFLICT OF INTEREST FOR HARPER?

	CONAGRA	RJR NABISCO
POSITION	Board of directors	Chairman, CEO
STOCK OWNED*	1,736,507 shares	622,222 shares

*As of Aug. 3, 1994

DATA: COMPANY REPORTS



HARPER: *A wealth of brands*

over as chief executive of RJR Nabisco last year, he raised eyebrows by keeping his seat on the board of ConAgra, the Omaha-based company he had previously headed. Harper maintained that the two

a direct competitor would lead to Harper's exit. Still, Harper could stay a force at ConAgra, where he owns 1 million shares. He has declared that he has no plans to sell his stake. *Greg Burt*

SHOW BIZ

BIG BLUE HIRES HYPERMAN

IS IBM'S NEW ROLE A Disney wannabe? Big Blue now has its very own superhero. IBM is pitching a Saturday morning cartoon series to TV networks that is based on its new \$49.95 interactive CD-ROM program. *The Adventures of Hyperman*—produced for IBM by outside talent—is a science program for ages 8 to 11. Kids are exposed to topics such as light waves. Using



MISSION: *Get interactive*

this knowledge and the help of great scientists of the past, Hyperman defeats villains Electro and K-Chaos.

So far, the company has had some "nibbles," says Cal McNeill, a manager with IBM's Multimedia Publishing Studio in Atlanta. Its CD-ROM titles include *The Interactive Science Encyclopedia*. IBM hopes

Hyperman will help it for ties to the networks for interactive-TV projects where these things become possible someday. *Ira Sager*

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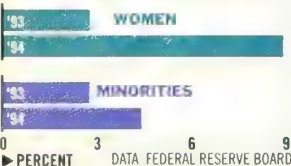
DIVERSITY

THE RAINBOW FED?

CONGRESSIONAL DEMOCRATS' criticism helped bring *glasnost* to the Federal Reserve earlier this year when the traditionally secretive central



SHARE OF FED WORKFORCE MAKING MORE THAN \$125,000 PER YEAR



bank began publicly announcing interest-rate policy changes. And now there's *perestroika* as well, at least in Fed hiring practices.

A recently disclosed ex-

change of letters between Fed Chairman Alan Greenspan and his leading congressional critic, Representative Henry Gonzalez (D-Tex.), suggests that the Fed has made big strides in bringing greater diversity to its top ranks, long derided as a white male bastion.

The share of employees in Washington making more than \$125,000 who are female has jumped from 2.8% a year ago to 8.9% (chart). Similar gains were made outside D.C., where Cathy Minehan became president of the Boston Federal Reserve Bank, only the second female ever to head one of the 12 regional banks. And the share of top-paid minorities has risen from 2.8% to 4.4%.

What's more, two-thirds of the regional bank directors named by Washington since 1991 have been women, minorities, or representatives of labor or consumer groups. Even Gonzalez has written Greenspan to "commend" the gains.

Dean Foust

SHOW BIZ

A MOVIE-MAKING MONEY MAN

HOLLYWOOD COMES TO THE Hudson again: Financier Kenneth Lipper, the former New York deputy mayor who helped write the 1987 film *Wall Street*, has a new movie. *City Hall* is a thriller that also draws upon his experience. Starring Al Pacino as the mayor, John Cusack as his idealistic young deputy, and Bridget Fonda as a police investigator, the flick is set to start shooting at the end of October, with a late 1995 expected release.

Lipper and Castle Rock studio are tight-lipped about the plot. Lipper will only say the well-meaning mayor comes to grief after a chain of events is set off by a child's

death in the crossfire between cops and crooks. Contrary to conventional wisdom that pols are no better than crooks, Lipper says his story "is not a cynical view, but gives true insight into how the system works."

A veteran of Salomon and Lehman, he got involved with *Wall Street* by chance when director Oliver Stone wanted to do a project on high finance and needed advice. Lipper wrote the

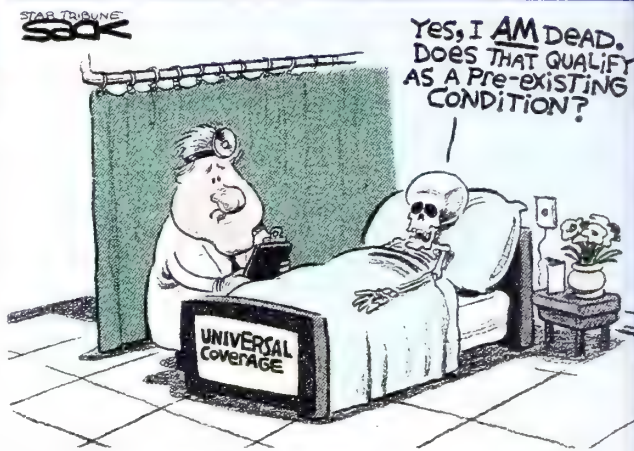
City Hall script on weekends while he built up his investment firm, Lipper & Co., which manages \$3 billion in assets. As with *Wall Street*, Lipper, 53, has landed a bit part in the movie, this time as the head of city council.



LIPPER: *Side job*

DRAWN & QUARTERED

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NEW WORLD ORDER

FROM RUSSIA WITH LOGS

THE SAWMILLS IN THE PACIFIC Northwest are having trouble getting enough timber, thanks, they say, to restrictions saving the habitat of the endangered spotted owl. So they are turning to the vast forests of Asiatic Russia.

Global Forestry Management Group—a consortium of 10 Northwest mills, a Seattle stevedoring company, and a Portland trading outfit—is committing \$9 million to lease 1 million acres of virgin woodlands and to build a port. Working with Russian partners, the group started shipping logging equipment to Russia on Oct. 2.

Getting the logs to the U.S. won't be easy, though. The

Agriculture Dept. doesn't allow imports of Russian wood unless it is heat-treated to kill pests. The U.S. construction industry doesn't yet have a system of structural standards for Russian lumber, which is mostly spruce and larch. Add in the problem of Russia's uncertain politics and economy. "There is a considerable level of risk," says



NEEDED: More timber for the mills

Howard Sohn, president of Roseburg (Ore.) Sun Stud, one of the partner sawmill companies. Sohn and his cohorts hope they can begin importing Russian wood by late 1995.

Dori Jones Yang

THE BIG PICTURE

THE BIG BUGS

Institutional investors have a pot of money—\$8.3 trillion in 1992, just-released data show. More than half of that is held by pension funds.

DATA: THE CONFERENCE BOARD, THE BRANCATO REPORT

PENSION FUNDS
\$4.4 TRILLION

INSURERS

\$1.6 TRILLION

INVESTMENT FIRMS

\$1.4 TRILLION

BANK TRUSTS

\$0.9 BILLION

FOOTNOTES 1995 Rolls-Royce Silver Spur III: \$169,000, after price cut of \$20,000 from '94. Four-door Chevy Blazer: \$19,851



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BIOTECH'S PAYOFF ISN'T ALL IN BUCKS

For analysts and financial advisers, biotechnology research has not paid off in the way they had hoped—through large financial gains for investors (“Biotech: Why it hasn’t paid off,” Cover Story, Sept. 26). But for those who carry inherited diseases, Joan O’C. Hamilton clearly identifies the real payoff: The new techniques and tools developed will play a major role in providing insight into many diseases that all of us hope will eventually be treated or cured by biotech research.

The most disappointing aspect of this report, however, is the side article on gene therapy (“Gene therapy: Promises, promises”). Although cystic fibrosis is one of the more well-known inherited diseases, it is not the most common. Hypercholesterolemia (FH), for example, which causes dangerously high blood-cholesterol levels in individuals, affects approximately 1 in 500 Americans in a

more mild form. Gene therapy trials in humans with FH are already under way, even though huge hurdles remain.

Kathleen Wodyka May
Vice-President
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Foundation Inc.
Fairfax, Va.

Your story is right on the mark. While the biotech companies captivated the media and Wall Street over the past 10 years, and yet have little success to show for their dreams, dozens of other high-technology companies were born in the medical industry during the 1980s. Unlike the biotechs, who swung for the fences, the high-tech medical-device firms set out to hit singles. The result? Real products, jobs, revenues—and profits. Often confused with the biotechs, the high-techs are the ones that are quietly winning.

James H. Walter
Director of Communications
Osteotech Inc.
Shrewsbury, N.J.

Your article focused attention on the companies attempting to develop and commercialize products to cure important ailments and diseases affecting humans. But you ignored the other biotechnology group—the one that developing alternatives for crop-protection chemicals and plants to better resist pests.

You can and should correct the impression that the only application of biotech is to produce new pharmaceuticals for human health care.

Venkat S. Sothi
Vice-Chairman & CEO
Bioscience Resource
Palo Alto, Calif.

In response to the cover language “Biotech: Why it hasn’t paid off,” I have one question: Paid off for whom? The industry has certainly paid off for the millions of people suffering from diseases who, thanks to biotechnology, are alive and doing well. It has paid off in terms of the creation of many jobs for



FOLLOW UP

“The industry has certainly paid off for the millions of people suffering from diseases who, thanks to biotechnology, are alive and doing well.”

Americans and has given the U.S. worldwide leadership position in a high technology field.

Too many companies? Maybe. Yet competition produces results and is not something to denigrate. Two hundred companies working on AIDS will bring about a cure faster than one or two. The benefit of having a small company built around a single technology or discovery is simple. With scientists focusing on one technique, and with little bureaucracy and distraction, more can be accomplished in a faster time.

Alison Kiley
San Francisco

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Readers Report

CORRECTIONS & CLARIFICATIONS

"Supermath for the real world" (Science Technology, Sept. 5) should have identified the site of the Center for Nonlinear Analysis as Carnegie Mellon University.

"These small-cap plums are ripe for plucking" (Inside Wall Street, Oct. 3) gave the wrong recent prices for two stocks. Ritec Medical, recently trading at 23, has a takeover value of \$32 to \$35 a share, according to investment adviser Charles L. Loggia. He says Salick Health Care, with a recent price of 22, has a takeover value of \$35 to \$40.

WHEN THE FED TALKS, FOLKS GET JITTERY

"At the Fed, silence isn't golden anymore" (Washington Outlook, Sept. 2) states "the glare of openness is unnerving financial market players used to being kept in the dark." This isn't correct. Policymakers' statements in the media are sometimes reckless, sometimes ill-advised, sometimes pure cheerleading and sometimes politically motivated. They terribly destabilize the market.

Robert Craven, President
Fixed Income Management Group
San Francisco

ATTENTION, KMART WATCHERS: THE CEO STAYS

I am writing to set the record straight regarding executive activities under watch at Kmart ("Is a new CEO on Kmart's shopping list?," In Business This Week, Oct. 3). It is true Kmart is actively searching for top executives and, as recently announced, has hired Marvin Rich as executive vice-president, finance and administration; Ronald J. Floto as president, Super Kmart Centers; and Kenneth W. Watson as executive vice president, marketing and product development. These talents add considerably to the strength of Kmart's management team. It is not true that Kmart is searching for a new CEO to replace Kmart Chairman Joseph E. Antonini.

Donald S. Perkins
Director
Kmart Corporation
Troy, Mich.

RAIDING YOUR RIVALS JUST ISN'T FAIR PLAY

Regarding "Lock the doors, it's ED" (Top of the News, Sept. 19), maybe I'm just an old-fashioned guy, but I was disturbed about Electronic Data Systems' approach to assembling a consulting



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Readers Report

business. I believe that if you want to be in a business, you build it—or, if you are in a hurry, you buy it. The fact that the court has enjoined EDS from conducting their raid on Arthur D. Little validates our position that their tactics were unlawful. Whatever happened to ethics, character, and integrity in business?

Charles R. LaMarr
President & CEO
Arthur D. Little
Cambridge, Mass.

"EPHEMERAL VALUES"? SAYS WHO?

Your article on Chase ("A chastened Chase," Finance, Sept. 26) is relevant to many organizations. That is why your comment about "ephemeral values" is so troubling. Values guide behavior. If, for example, an employee doesn't believe the customer comes first, no amount of selection, training, or memoranda will prove very effective in having the employee behave that way, though the customer comes first.

Robert G. Stemmer
Sunnyside, N.Y.

EQUIFAX DOESN'T SELL CUSTOMER LISTS

We were dismayed that "Database marketing" (Cover Story, Sept. 5) was misleading in its mention of Equifax. In August, 1991, Equifax discontinued sale of direct-marketing lists derived from consumer credit files, and your article implies that Equifax still sells those lists for general marketing purposes. Equifax now only sells Federal Trade Commission-approved prescreening services for credit offers and marketing services based on the credit file. Our research showed consumers were in favor of receiving offers of preapproved credit.

Kristen A. Petre
Public Relations Assistant
Equifax Inc.
Atlanta

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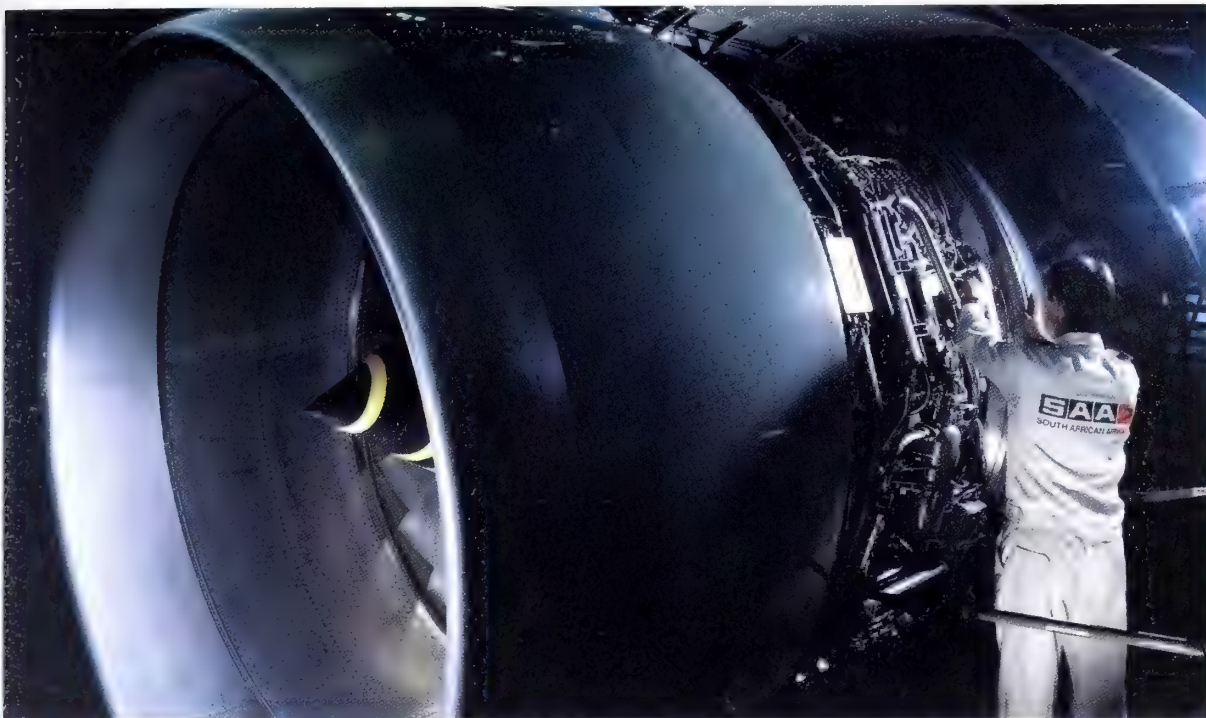
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A LA MODE: A decade ago, just 3% of the camembert consumed in France was made from raw milk. Today, the share of farm-style cheese is 10%



VIVE LE CAMEMBERT—MOLD AND ALL

In a shed behind her ancient Norman farmhouse, Jacqueline Bignon dips her plump arms elbow-deep into a metal tub full of warm, raw milk. She mixes in a thimbleful of liquid enzyme—a natural curdling agent—from a calf's stomach and soon is kneading solid curds. With a plastic dishpan she skims off the watery whey and pours it on the cement floor. Then she ladles the curds into small containers and sets them to age in a dank, moldy storeroom. In four weeks, this 65-year-old farmwife will head off to village markets with some of the most luscious cheese on earth.

NATIONAL PRIDE. Madame Bignon's father taught her to make cheese 50 years ago. "Every farm used to make it," she says. No more. In the lush, rolling pastureland around the Norman village of Camembert—France's most famous cheese region—most farmers now sell their milk to big factories. One modern white *fromagerie* that sprawls across a hillside could as easily be a semiconductor plant. Inside, employees wear hygienic white coats and caps and use immaculate stainless-steel equipment. The plant produces 80,000 cakes of camembert cheese a day. Madame Bignon makes the region's other two varieties, *pont l'évêque* and *livarot*, turning out a mere 400 a week.

Not only that, these days the round, gooey camembert that is France's "national" cheese is made almost entirely from pasteurized milk. The process is cheaper, but the taste is bland compared with the earthy tang of the raw-milk type. France's shift to pasteurized cheese is ironic, because French gourmets have long scoffed at hygiene-obsessed Americans. U.S. law bans imports of raw-milk cheese other than hard, dry varieties that have aged for at least 90 days. That rules out France's best products.

In this drizzly, emerald-green corner of northern France a handful of farmers and cheesemakers now is reviving their region's dying art. In France as in the

U.S., the onslaught of processed food, spawning a comeback for simple, traditional products. A decade ago, just 3% of the camembert consumed in France was made from raw milk. Today, the share of farm-style cheese has passed 10% and is climbing.

"Pasteurized cheese tastes insipid," says François Durand, an energetic 38-year-old dairy farmer. His 40 cows graze beside sheep, geese, and chickens on misty hillsides dotted with apple trees. Durand began producing old-style camembert from raw milk when he was 18. He cites local pride as the reason. "Someone needed to keep real camembert alive" in the village that gave the cheese its name, he says.

PENICILLIN, ANYONE? Durand is a whirlwind worker who can't stop ministering to his racks of ripening cheeses. He rushes around his *fromagerie*, rolling cheeses on a small screen to pull off loose crumbs and shaking salt over today's production. Salt not only adds taste but also encourages flavor-producing penicillin to grow on the white crust. Penicillin mold clings to his walls and spreads to the cheese through the air. Big producers spray penicillin on the cheese. Allegedly, a daily diet of the antibiotic-laden cheese keeps Normandy children healthy.

A few hundred yards down the road lives Normandy's only other farmer still producing camembert from the milk of his own cows. Michel Delorme is a grizzled, suspicious man of 60 who is almost toothless. He began making cheese about the same time as Durand. He claims to supply top Paris restaurants and French celebrities, including Fren-



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Letter From Camembert



WE'RE NO. 1: The French eat the most cheese yearly—50 pounds each

President Francois Mitterrand—although other cheesemakers are skeptical. Recently, Delorme had a setback: Agricultural authorities ordered him to shut down for a month to correct poor sanitation. Raw milk and the cows that give it require special care to block salmonella and other nasty bacteria.

This region's return to its roots clearly carries health risks. Some large-scale makers of unpasteurized cheese here worry that small farmers' cheeses will make consumers sick and tarnish everyone's products. A cheesemakers' association that bestows a quality label on camembert hasn't yet given it to either of the farm producers. "They'll never get it," claims a large competitor.

PAPA'S RECIPE. Three years ago, Brussels regulators considered banning all raw-milk cheese in the European Union. The French screamed at the idea, promoted by northern dairy countries led by Denmark and the Netherlands. Britain's Prince Charles saved the day for France. During a visit to Paris, he told a journalist it would be a shame to stop eating all those delectable French cheeses. The threat from Brussels quickly faded.

Now, Brussels rules are actually pushing some Normandy farmers into homestyle cheese production. To cope with a European milk surplus, a quota

system set up in 1986 is gradually cutting output at dairies around Europe. Madame Bignon and her family decided in 1988 to escape a cut by converting milk into cheese. She hadn't made cheese for 35 years but remembered her father's recipe. Each of her 14-ounce pont l'évêque cheeses requires nearly four quarts of milk. About 10 farmers now make mild pont l'évêque and the more pungent livarot, which aren't as easily mass-produced as camembert.

In quantity, Normandy's farm cheeses are still a drop in the milk bucket. But there's a renaissance, too, among midsize factories that use raw milk collected from farmers to make old-style cheese. One of the best is the family-owned Domaine de Saint Loup, which has made farm-style camembert in the same 17th century water mill for 100 years. Owner Philippe Meslon dreams of starting a dairy farm and making his own cheese. But at 54, "I doubt I ever will," he says.

Meslon is doing just fine, however. He's selling all the raw-milk camembert he can make—for \$4.3

million a year. In contrast to most producers, who hate visitors, Meslon building facilities so tourists can watch the cheese being made. And he's getting calls from people who want to buy his business, including German and panese investors. For now, it's not for sale. "My wife was born in the room above the office," Meslon explains.

Other cheesemakers aren't so sentimental. A big family-owned company, Besnier, has scoured Normandy in recent years, buying up almost any producer who will sell. It has become undisputed king of camembert, with annual sales of \$4.4 billion. It even has acquired cheese factories in the U.S.

HOT WITH JAM. Unlike such classic French products as champagne and gnac, camembert lacks a protected name and can be made by anyone. At the tourist center in Camembert—a drab, seaside village of 185 souls—a display case contains "camembert" boxes from Australia, Romania, Japan, and a dozen other nations. German camembert is served hot with jam on top. "Affreux!"—frightful—shudders Jean Gaubert, the dairy farmer who is mayor of Camembert.

In a health-conscious age that has seen France's wine consumption fall 20% over the past 10 years, you'd think the eating of France's rich cheeses would likewise be in decline. Not at all. Each French person ate 50 pounds of cheese last year, up from 44 pounds in 1982, topping the No. 2 Italians. Americans ate 29 pounds each, perhaps mostly at McDonald's: The U.S. took a tiny 2% of French cheese exports.

Camembert's cheesemakers wish Americans could taste the real thing. The locals still talk of an American businessman who made a pilgrimage here in the

1920s to thank local cheesemakers for curing his lifelong stomach problem. Medicinal value aside, the buttery cheeses of Normandy are one of life's pleasures. It's good news for food lovers that cheesemakers such as Madame Bignon are returning to their abandoned tub

STEWART T.

To go, BUSINESS WEEK Paris Bureau Chief, eats his camembert without the crust, as do the makers.



"Pasteurized cheese tastes insipid. Someone needed to keep real cheese alive."

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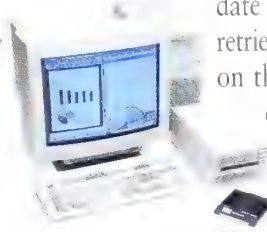
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FROM QUALITY TO QUANTITY

"It's Very Well Made in Taiwan" aptly describes the renaissance of the Republic of China's meticulously made products. To achieve world-class eminence, as Taiwanese manufacturers see it, you must start with an innovative design, produce to the most professional standards, package with finesse, market with a competitive flair and provide service with the customer's finicky needs clearly in mind.

Trumpeting the new look of Taiwanese products are the 1993 winners of the Gold National Award of Excellence: Acer, Pro Kennex, Giant, Proton, San Yang — their brand names are propelling the republic into the forefront of talked-about Asian Tigers. In Taipei, the nation's capital and business hub, the word is out that product quality means trade growth. Turn out a product with high perceived value, and world markets will walk to your door.

The boom in brand-name products with recognition value throughout global markets is very much a home-grown phenomenon.

"Few countries have matched the explosive economic development that the Republic of China has enjoyed over the past three decades," says P. K. Chiang, Taiwan's Minister of Economic Affairs. "Since 1970, our average annual growth rate has exceeded nine percent — one of the fastest in the world. Today, with a per capita income of more than \$10,000 and some \$85 billion in foreign exchange reserves, Taiwan is ready to be counted among the ranks of developed nations."

PEDALING PROWESS Monex Mountain Bike by Giant



A bike looks simple — just a seat, a frame, handlebars, pedals and two wheels. Not much more to it. But in today's demanding market, a bicycle is a piece of high technology requiring an ingenious combination of elements, from strong but lightweight metal to intricately arranged gears. Add to that the incredible increase in bike lovers in markets that were once just so-so — the massive American market — and you have a challenge for any manufacturer, particularly one that's a newcomer in a crowded field.

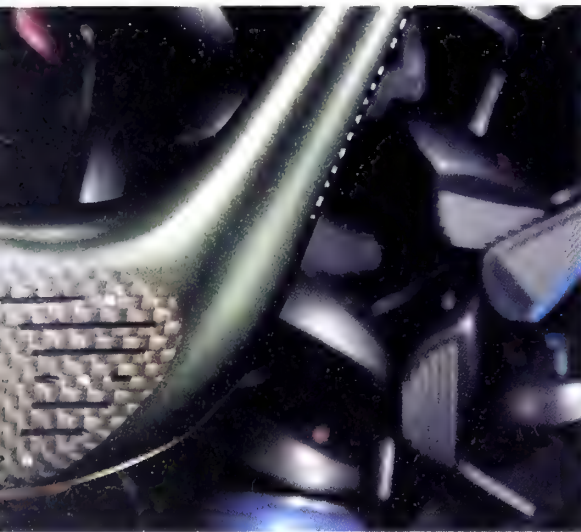
Dedicated and design-smart, Giant Worldwide of Taiwan is a Gold Winner for its Cadex line of mountain bikes, last year and — again — this year. The award-winning Monex, with a carbon rather than aluminum frame and 24 speeds, awes both aficionados and the affluent — as much for its good looks as its technical advances.

In the mid-80s the Taiwanese company set up Giant Bicycle Inc. in Rancho Dominguez, Calif., and soon captivated consumers and dealers alike with its down-to-earth approach: Sell a sophisticated product at an attractive price and build a strong dealer network.

In only a few years Giant's sales soared from \$6.5 million per year to 10 times that amount — with an accompanying expansion of dealerships from 500 to 1,600. Today the company's products are No. 3 in the U.S. bike market.

Giant's bikes have set a fast pace. In 1991 the company





unched its Cadex line of high-tech competition bicycles constructed with carbon-fiber frames. At about the same time Giant introduced its Ready-to-Ride program to dealers, shipping bikes virtually assembled and ready to go out the store door. The company's mix of innovation and value led *Mountain and City Biking* to name the Giant ATX 770 mountain bike as the "1992 Bike of the Year." And Giant's Iguana model won accolades from consumer advocates as a "Best Buy." From bicycles to exercisers is only a turn of the wheel for Kunnán — and a market it is now entering.

POWER PACK IGS 1000 Golf Club Series by Kunnán

From Japan to the U.S. to Europe, golf may well be the fastest-growing sport in the world. Millions of new golf buffs join its ranks each year, entranced by the beauty of the game — it's mesmerizing when you see a Greg Norman or Nick Price or Jack Nicklaus on the pro circuit on TV, driving, putting, smiling when the going's good. The boom in new courses has also given the game plenty of lift.

But nothing has done more to put power into the hands of drivers — and make golf more playable — than Kunnán Golf, a Taiwanese company that has taken golf equipment to new heights of sophistication. Its oversized driver is the first club of its kind in the world — one-piece and all-graphite (with a metal face). It's as accurate as it is powerful. No wonder that the design, plus the follow-through

in producing a quality product, led to a Gold National Award of Excellence.

The IGS (Integrated Graphite System) 1000 clubs, even further refined as the 2000 Series for the 1994 market, give golfers the unparalleled distance of graphite clubs with the strong feel of metal woods. Thanks in part to a graphic shaft that weighs an impressive 37% less than an ordinary graphic shaft, Kunnán's clubs are the lightest you can buy. You can see why they've already shown up on the Senior PGA TOUR.

Could Kunnán Lo, son of a Taiwanese plastic-toy manufacturer, have ever imagined all this some 25 years ago when he started Kunnán Enterprises to make badminton racquets? His goal of turning out quality products paid off. Within three years, his company had carved out an enviable position as the world's largest manufacturer of tennis racquets — at first, under a major brand name, later under Kunnán's own Pro Kennex label (now one of the three best-selling brands in the U.S.). By the mid-1980s, the company was applying its talent for designing and making sports equipment to the highly competitive golf arena. The rest is Taiwanese history. For Kunnán Lo, the driver's success is par for his corporate course.

PICTURE PERFECT Brilliance Monitor by Philips



Not many products win Japan's Deming Award, named after the American industrial crusader who relentlessly promoted the importance of quality control. But Philips Taiwan's 17-inch Brilliance 1720 professional monitor did take top honors in the Deming sweepstakes. And so it wasn't entirely a surprise when this precision monitor also won Taiwan's Gold National Award of Excellence. The accolade hardly raised an eyebrow in Silicon Valley where software programmers and graphic artists now routinely depend on made-in-Taiwan, high-resolution monitors in their everyday work.

The Brilliance monitor is the outcome of an ambitious corporate game plan that called for Taiwan Philips to prove its



superiority" over competing brands. In its design strategy, Philips is absolutely flicker-free, easy to view from any angle despite its other features. It meets Sweden's tough environmental emission standards.

It combines 90s ergonomics with state-of-the-art digital technology, seldom found all in one large-screen monitor.

Through vertical integrated production, Philips is using close control over monitors manufacture. The company makes every part in-house. Philips is proving to be as bright as its Brilliance pictures.

TOMORROW'S TELEVISION DT-3660 Wide-screen Digital TV by Proton



edges in night vision and accorded it the Gold N.

More as hard sharp and color accurate as



anywhere. But look at what else it does: Proton's protégé is fully digital (great for line-by-line definition), very wide-screen (with four sizes — wide, wider, letter box, regular) and amazingly multimedia (programmed to handle about every known signal from a laser-disc player to a camcorder or TV game).

If two-way communications really comes down that highway, the DT-3660 will be there, ready and waiting with many electronic skills — among them, HDTV (High Definition TV) and optical-fiber cable jacks that would replace the PC monitor in your house. Wrapped together in a high-tech consumer package, Proton's product is well along the road toward making VCRs, faxes and phone obsolete. It's made-to-order for cutting-edge consumers who enjoy planning their household communications around a TV monitor that lets you receive — but send as well.

The DT-3660 has more sophisticated functions than any other TV ever produced — some practical, others designed for leisure-time breaks. Catapulting Proton to the pinnacle of acclaim is its commitment to exploring future technology — now. As anxious as anyone to get on with electronic exploration, Proton is protean in the way it examines the diverse ways in which TV technology can develop. Whatever direction, you can bet that

STREAMLINED SECURITY Fingerprint Verifier FC100 by Startek



You step up to an ATM machine, prepared to enter your PIN — and it recognizes you by

camera? Not at all. It's the workings of fingerprint technology, developed by Startek of Taiwan. With its award-winning Fingerprint Verifier, your very own fingerprint becomes the open sesame to ATMs, your front door, your

safe. But Startek's Fingerprint Verifier takes off from British research, mostly done in the 19th century partly with Scotland Yard in mind, that found that fingerprints are unique and unchangeable and



lend themselves to classification.

Fast forward to the 1980s when Startek, a HsinChu Science Park startup, drew on technology developed by Professor Wen Hsing Hsu of Taiwan's National Tsing Hua

University to create a commercial live-scan system for recognizing a person's fingerprint. It would have many applications, from law enforcement and immigration checks to hotel-room security and personal banking. With a high-tech flair that is commonplace in Taiwan these days, the company came up with a fully automatic identification system that is considered the best and most accurate in the burgeoning fingerprint-recognition business. In seconds FingerCheck reads your fingerprint, compares it with the one in a computer database and says, in effect, "You're you. Or you aren't." Among the system's neat features: it rejects counterfeit fingerprints, takes only two to three seconds for one-on-one matching, prints out a replica of your fingerprint and works well with small-size ID cards and optical cards. You can see why Taiwan's quality-product judges are showering Startek with praise — and giving it a Gold National Award of Excellence.

TOOL Feeler Vertical Machining Center by Fair Friend

 Machine tools are the unglamorous, behind-the-scenes workhorses that cut, slice, drill, mill and shape metal and plastic at various stages in the production cycle. They're vital — and necessarily versatile.

For the Fair Friend Group, one of Taiwan's largest conglomerates, vertical machining is an art requiring the most precision. The company's Feeler FV-800A can do that with uncanny skill. In operation, the Vertical Machining Center keeps the work piece stationary while the tool moves, thus ensuring greater accuracy, longer reliability and closer quality control. The machine has such flexibility and adaptability that it can satisfy

the needs of almost any end-user. That's crucial because of rapid product changes in today's volatile markets.

Taiwan's Gold National Award of Excellence, now bestowed on the Vertical Machining Center, caps a corporate career that has put Fair Friend in the forefront of the machine-tool industry. Even during the recent worldwide recession in machine tools, the company managed to grow about eight times faster than the industry as a whole. With the Feeler's innovative design, the company is competing head-to-head with Japan's Hitachi Seiko, the front-runner in vertical machining. (Germany is second; Taiwan, third with Fair Friend dominant.)

Who are Feeler's main customers? Some are in its own backyard. The company sells to YuLung, Taiwan's largest automaker, and Taiwan Aerospace, which uses Feeler-machined parts in its homegrown fighter plane, the IDF. But Feeler is also tapping into overseas markets with rapidly growing annual export sales.

As a leading Taiwan conglomerate, Fair Friend has more than 40 machine tools in its stable. It makes everything from PC motherboards and power tools to elevators and parking systems. But for a cameo portrait of the ROC's dramatic conversion from a low-end producer to a high-tech performer, few companies can equal Feeler. Its fast-selling Machining Center is indeed "Very Well Made in Taiwan."

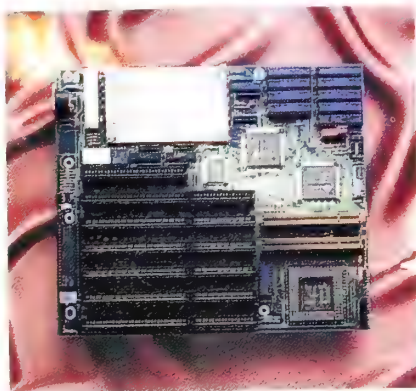
INGENIOUS INTERFACE Dual-Frequency 386/486 Chipset by UMC



Among Taiwan's strongest manufacturing suits are computers and peripherals. ROC plants produce some 80% of the world's motherboards and mice, about 50% of all monitors, keyboards and scanners, more than 30% of



notebook computers and 150 million finished personal computers worldwide. If Taiwan suffered from a severe brain drain to the U.S. in the 70s and 80s, it's now seeing just the reverse — with many engineers taking good-paying jobs in the computer industry or at HsinChu Science Park, the world's largest and most successful



technology enclave targeted at export markets.

Front and center in this can-do computer arena is United Microelectronics — with its award-winning Dual-Frequency

386/486 Chipset. For three years in a row, Taiwan college graduates have rated UMC as their No. 1 choice for employment. Why? Because the company has proven to be both solid and street-smart, cleverly anticipating that Taiwan would become the center of the world's motherboard production.

With its breakthrough dual-frequency design and VLSI (Very Large Scale Integration) technology, which aids miniaturization, UMC has been able to mass-produce a chipset that's both high-quality and low-cost. The chipset serves as a crucial component that controls the traffic between various interfaces such as the RAM (Random Access Memory) and a computer's CPU (Central Processing Unit), yet constitutes only one-fifth of a motherboard's cost.

As quality-oriented as it is cost-conscious, UMC has shared a 20% share of the world market for chipsets. Now it wants to become a one-stop shop for an entire range of chips and chip-based computer products, including CPUs. Like a Taipei typhoon, it's barreling ahead with every prospect of meeting its product goals.

RETRO RACER Classic 7 City Bike by Merida



It looks like something from the 50s. But thanks to virtuoso engineering, it rides like the 90s.

This is the Classic 7, made by Taiwan's Merida and honored as a winner of the Gold National Award of Excellence — a traditional bike that should weigh a lot but, in fact, is almost as light as a feather. It's even painted in light colors such as white and yellow to help give that feeling of weightlessness. Yet thanks to the novel use of aluminum, it can glide over any city terrain like a surfer through water.

Mountain bike? The name comes from the breed's versatility and toughness in negotiating slopes and ravines and back roads. With Classic 7's graceful curves, toned-down colors and energy-saving design this bike uses mountain bike technology tailored to fit city streets while retaining its outdoor power. It may look like a throwback to another era, but it has all of the technological pizzazz of state-of-the-art mountain bikes.

Merida is a rising star — now second-ranking as a Taiwan bicycle brand. Its mountain bikes are a big hit in Europe. And its Classic 7 is a success story in Japan where bicyclists want a traditional bike that's an easy ride. Will America's city dwellers, especially young women and the older crowd, find comfort in Merida's Classic 7? You'll soon see.

The text was written by Paul Burnham Finney, a New York-based business journalist who has seen Taiwan industry in action.



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PRINT FOR A NEW JAPAN
Rethinking of a Nation
Ozawa
\$25

THE JAPAN THAT COULDN'T SAY NO

When Japanese power broker Ichiro Ozawa published this fluid, accessible polemic in his country last year, it soared to the best-seller lists. Reportedly, eager to discover what Japan's influential and dynamic politician had to say—had it private—translated into English. Now the book is available in an official—and deft—

translation. *Blueprint for Japan: The Rethinking of a Nation* of an un-Japanese an up-close look at about Japan's future rocking the country might well alter its policies and or.

Ozawa's overarching is that Japan must end creating and buting domestic and become what the world community sees as a "normal na-

tion. Only then can it become a "globalite," do its part to maintain peace and stability and freedom, and deserve its own prosperity. Specifically, Ozawa calls for Japan to open its arms aggressively, become more "transparent" in the conduct of government and business, deregulate its economy to become more decisive, participate actively in U.N. peacekeeping efforts to become a regional leader in Asia, use foreign aid as a more potent diplomatic weapon.

One reason the book has stirred furor is that many Japanese think that Ozawa has them in mind—though he says so explicitly—is a stronger, more powerful military. This is highly controversial in a nation whose people support the "peace constitution" and on it by the U.S. after World

War II. The constitution, which underlies Japan's restricted role in U.N. peacekeeping operations, also precluded Japan from sending meaningful military support to the Western allies in the Persian Gulf War. Many Japanese strongly disagree with Ozawa's scathing criticism of how reluctant Japan was to provide even financial aid to the allies, as well as with some of his ideas for tax reform, including a higher consumption tax.

Blueprint is of enormous interest at home and abroad because Ozawa—arguably the boldest, most provocative and visionary Japanese political leader of the past two decades—could well end up running the country. In 1993, after years of helping to lead the long-ruling Liberal Democratic Party, he walked out, taking many followers with him. His departure sparked

other defections and the creation of several new parties that ultimately coalesced to bring the LDP down. As co-leader of the largest breakaway party, Ozawa—the savviest of the renegades—orchestrated the formation of a coalition to select Morihiro Hosokawa as the first non-LDP Prime Minister in 38 years. He effectively ran Hosokawa's one-year government in a "Shadow Shogun" role.

Ozawa suffered a major setback last June, when the LDP surprisingly joined with the Japan Socialist Party to wrest control from his coalition. And his tough backroom maneuvering has made him many enemies. Still, he remains highly influential and is busy trying to form a grand new party.

Should Ozawa get a chance to run Japan according to the precepts put forth in his book, the Japanese—and the na-

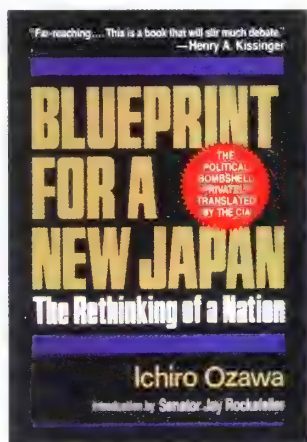
tions that deal with Japan—will be in for startling changes. Cartels, price fixing, bureaucratic administrative guidance, collusive bidding on construction projects, and opaque governmental decision-making would disappear.

Among Ozawa's themes is the need for Japanese to assume more responsibility for their own well-being. In Japan, one of the book's most talked-about passages is Ozawa's account of a visit to America's Grand Canyon. He was amazed to find no fences, attendants, or signs warning tourists away from the canyon's edge. "I tried to imagine the scenario in Japan if an accident occurred," he writes. "The press would criticize the park management in the harshest terms. The newspapers and television would demand to know how the authorities could have been so negligent.... Japanese people take it for granted that we are always under government protection."

On the political front, Ozawa prescribes a revamping of Japan's system to clarify accountability and strengthen decision-making. Already, his advocacy of these ideas is sparking a massive electoral redistricting that could propel dramatic political realignment and more responsible government.

Perhaps most important, Ozawa calls for a complete rethinking of political decision-making. Japan's leaders, he says, are unable to reach decisions or take responsibility for them. In part, he blames the diffusion of power among political and bureaucratic institutions. "Japanese are generally fearful of the concentration of power," he writes. "We prefer to stumble along, leaning on each other in what could be termed the politics of collective irresponsibility.... It is now imperative that Japan build a system in which those who have been democratically delegated authority take responsibility for decision-making." Specifically, Ozawa calls for a clearer concentration of power and leadership in the Prime Minister's office.

Ironically, this attack on Japanese decision-making echoes "revisionist" critiques of the country by such Western analysts as Karel van Wolferen, which have focused on the lack of a center of political accountability. Japanese *apparatchiks* have spent the past few years furiously debunking the revisionist line. Now this consummate insider has en-



OZAWA CALLS FOR TRULY FREE MARKETS AND A GOVERNMENT THAT OPERATES IN THE OPEN



386-based PCs

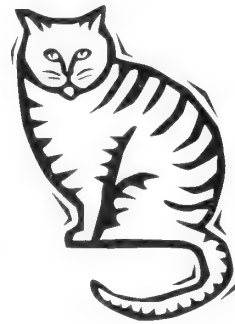
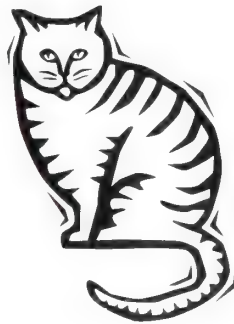
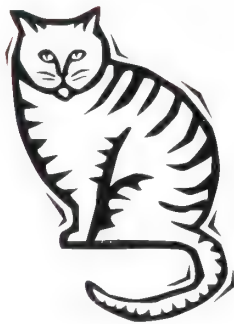
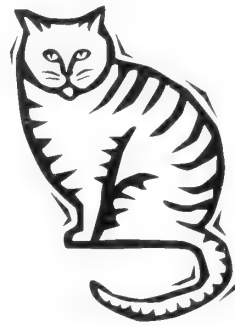
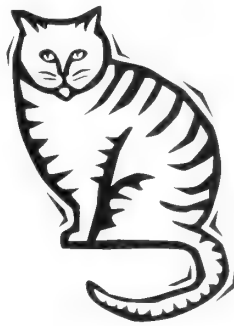
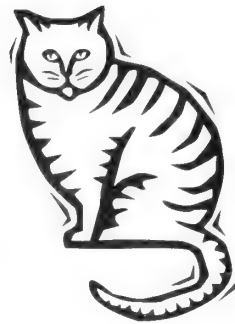
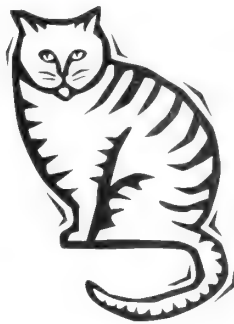
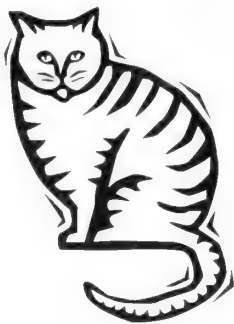
486-based PCs

Let's say comput



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Books

dorsed it—perhaps with the dream of someday becoming a powerful Prime Minister himself.

BY ROBERT NEFF

Neff is BUSINESS WEEK's Tokyo bureau chief.

BOOK BRIEFS

INVESTMENT BIKER

By Jim Rogers
Random House • 402pp • \$25

BREEZY RIDER

How's this for a macho fantasy? Wealthy and pushing middle-aged you decide to chuck the daily grind and see the world. You put your affairs in order, zip up your leather jacket, climb on your BMW, and take off, your twenty-something girlfriend at your side.

For Jim Rogers, global money manager turned Columbia B-school professor, cable-TV finance guru, and curmudgeonly conservative, this was no dream. In 1990, Rogers set out to circle the globe with Tabitha Estabrook, a "tall, leggy blonde" and practicing liberal. The 65,000-mile trip led to this long-winded but entertaining travel-and-investment guide to some of the world's most flourishing economies.

Pondering which emerging markets to invest in? Rogers' advice is sage: Stick with nations where hard-nosed bureaucrats push fiscal reforms, maintain sound currencies, advocate free trade, and—most important—stay out of areas left to the private sector. The last is the theme Rogers harps on, whether knocking Western Europe's costly social safety net or dissecting statist Algeria's troubled economy.

Fortunately, Rogers also dishes up ample adventure. For more than 20 years, Rogers and Estabrook skid along faint trails in the Sahara, dodge bulldozers in a remote part of Chile, and face down the corrupt officials who pass for lawmen in backwoods Zaire. Never do they lose their sense of amazement. And never does Rogers run out of investment ideas. He dives into the stock markets of New Zealand, Ecuador, and Botswana, whose currency is as hard as its diamonds and whose government "had decided the country should be full of capitalists." *Investment Biker* may be a fantasy trip, but it never strays far from Rogers' longtime personal quest: to make a buck off the global economy.

BY WILLIAM GLASGOW

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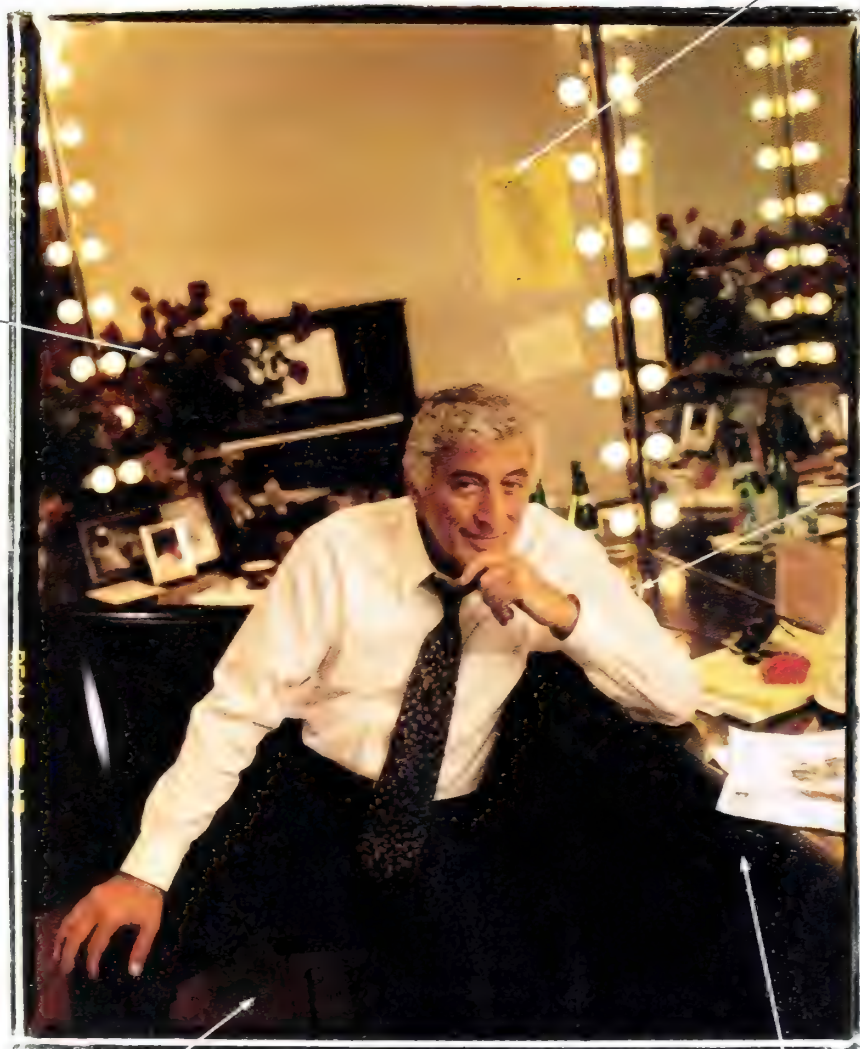
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TONY BENNETT/at work

The set list.
It's all about finding the right tempos,
the right nuances. Sound easy?
"It took me ten years to write this list."

The flowers are a
reminder of the great
Duke Ellington,
who would send a dozen
roses whenever he'd
written a new song.



The dressing room at
Radio City Music Hall
is a place Tony is intimately
familiar with.
No wonder, since he lives
only a block away.

Tony Bennett's art isn't limited to singing,
as these sketches show. His favorite
subjects are other performers.
"I always paint from life and 98%
of the time I'm around musicians."

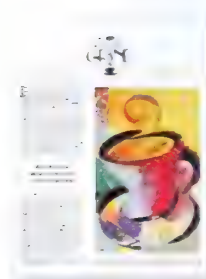
Mr. Bennett has graciously donated his appearance fee to the Juvenile Diabetes Foundation.



"I like it understated, I don't like it obvious."
It's a philosophy that's apparent in Tony's clothing
as well as his music. Case in point:
his classic white Arrow 1851 wrinkle-free dress shirt.



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HOW-AND-TELL WHAT'S EASY AS PIE

If you're like me, getting up in front of an audience is not the favorite part of my day. Technology can't make the butterflies out of my stomach, but it can make my presentations a lot more effective.

My artistic abilities are nil. With the hardware and software readily available today, even I can turn out visual presentations that add punch to my pitch, whether I'm talking to an audience full of associates or meeting a customer one-on-one.

There are two basic methods for computer-assisted presentations. The older approach is to use your printer to produce transparencies that can be displayed with an overhead projector. Use a computer to create the slides, and you can put on a show with animation around.

D'S PLAY. Whichever you go, your first problem is designing the visual presentation. Many software tools can help. Presentation graphics programs, such as Microsoft's PowerPoint (for Windows and the Macintosh) or Paris Impact (Mac only), produce slides that incorporate text, graphics, and all manner of fancy color effects. The effective use of these requires a fair investment of time in learning. If you use them only on occasion, you may not find the effort worthwhile.

Your word-processing program can be an effective presentation tool—one you already know how to use. Microsoft Word or WordPerfect won't give you special effects, such as color blends or gradients, but they will produce clean, readable slides and can incorporate graphics



and clip art. Provided you only want to do overhead slides, word-processing software may be all you need. All laser and most inkjet printers can produce transparencies if you use film (50¢ to \$1 a sheet) in place of paper. Of course, most printers give you boring black and white. But color printers are making their way into many offices (BW—Sept. 26). And many business service centers, such as Kinko's, will rent you time on their computer and printer to produce color transparencies at a cost of \$3 or so a sheet.

A show displayed directly

from your computer requires heavier-duty software and hardware. A presentation graphics program is generally needed to put your images in order and display them. If your needs are very simple, Broderbund Software Inc.'s \$39 KidPix may do the job. Although it is designed as an educational and entertainment program for children, it's quite capable of turning out a business presentation.

MOUSE POWER. Then there's the matter of displaying the pictures. A small audience can crowd around a laptop, but bigger groups require big screens. Here you're generally at the mercy of

the audiovisual facilities available. You can use a portable projection panel that works with an overhead projector. But these devices, which look something like a laptop screen without the computer, are both tricky to use and expensive, with prices ranging from \$1,500 for a monochrome unit to \$5,000 and up for active-matrix color.

Fortunately, most conference facilities can provide either a large-screen data monitor or a video projector into which you can plug a computer, including a laptop, with an external VGA video connector. You also will want a remote-control device that functions as a long-range mouse so you can control your show while pointing out features on the screen.

One final bit of advice: Think big. Many a time I have sat in the back of a ballroom squinting at the too-small text on a distant screen. Your graphics may be terrific and your colors may be dazzling, but you won't impress the audience unless they can read what you're saying. S.W.

BULLETIN BOARD

SCREEN PHONE

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Want to hook into the Information Age but hate the thought of a computer on your desk? A screen phone can give you access to many of the same on-line information services as a PC but is only slightly bigger than a business telephone.



The SmartPhone from SmartPhone Communications (203 353-5950) can provide you with financial-market information from Standard & Poor's ComStock, news from Dow Jones, credit data from Dun & Bradstreet—or a bouquet from PC Flowers. The device uses a postcard-size liquid-crystal display screen. You enter commands through an expanded telephone keypad or make selections from on-screen menus.

The SmartPhone sells for \$199 plus \$29 to \$49 per month, depending on the services chosen.

OPERATING SYSTEM

HOSTAGE SOFTWARE?

Computer shoot-'em-up games are a big reason why you won't see the new Windows 95 operating system until next spring. Microsoft has promised that the new software will run programs that worked either with Windows or MS-DOS. So far, DOS-based games are proving to be the toughest challenge. A soon-to-ship test version, known internally as M7, is expected to solve many of the system's compatibility woes.

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BY RUDI DORNBUSCH

WHAT'S MISSING AT THE LATIN SUMMIT: FREE TRADE AND A FREE CUBA



LET'S HOPE
hemispheric
leaders have
the gumption
to hijack the
summit
agenda and
take a
loud and
angry stand

Nothing much ever happens at summits, which promises to be all too true of the Summit of the Americas to be held in Miami on Dec. 9-11. What can be expected of a meeting at which tiny countries get together with the U.S., Canada, Brazil, and Mexico? It's as if the thinking is that everybody deserves a summit—a job summit even at full employment, an Asian summit so Asia doesn't feel left out, a G7 summit to make sure the bonding goes on. And now, of all things, a hemispheric summit.

The official agenda lists three broad themes: making democracy work, making democracy prosperous, and making democracy endure in the hemisphere. Disappointingly, the proposed initiatives amount to little more than a catalog of social progress long on dreams and short on realism. Here are some topics: "No to corruption, battle plan against the drug cartels, making civil society work, universal access to education, microenterprise finance, equitable access to basic health, upward harmonization of environmental standards, partnership for nature." All in all, it looks like the Clinton campaign platform *en Español* or an employment program for social workers, displaced liberals, and the White House health-care team. Earth to Washington: Get a grip.

JUST KIDDING. Only two issues are worth discussing at an Americas summit. One is a demand that the U.S. live up to its promises and immediately start broadening the North American Free Trade Agreement to include countries to the south, starting with Chile. Another is a call by all of the Americas for Cuba to turn to democracy and for Fidel Castro to get out. Most everything else is pie-in-the-sky or issues that could be handled by a commission, a consular clerk, or best forgotten.

The expansion of NAFTA, promised by both George Bush and Bill Clinton, became a victim of the Clinton Administration's botched legislative calendar. First, it was to piggyback on the General Agreement on Tariffs & Trade, but both measures were held off too long. Then, fast-track for Latin American free trade was jettisoned to give GATT a better chance of passage. If the White House mismanaged the timing, the Republicans get much of the blame for taking advantage of it. The result: Bye-bye, free trade for the Americas.

The present amorphous status of NAFTA expansion is admirably captured in the official State Dept. prose: "The Summit offers the

opportunity to affirm visions of free trade in the Western Hemisphere." But visions won't help Chile and Argentina, where policymakers have already put in place reforms on the assumption that an open trading system is most at hand. Now, they find they are out in the cold, at least until further notice. Investors are shying away from the uncertainty, resulting in a lack of capital that impairs the viability of the policy reforms.

WALK SOFTLY. The recent rash of free-trade agreements in Latin America was based on the expectation that NAFTA would soon be expanded into a regional trading zone. That vision has been blurred, and with it much of the credit Bush and Clinton got for starting the NAFTA process. It is absurd for the U.S. to urge free trade on its partners, promise most immediate action, and then turn its back. But that is exactly what has happened. A summit will be a cover-up at best. Let's hope Latin leaders have enough self-respect and independence to hijack the agenda and take a loud and angry stand on this issue.

Now, let's turn to Cuba: Along with North Korean leader Kim Jong Il, Castro is the cold warrior still in place. His dreams have crashed, Cubans are disillusioned, the Cuban Republic model of democracy and a free market is obvious and no longer controversial, even in Cuba. Cubans are hardworking and bright—they would hit the ground running and make a quick success of transition. Castro isn't about to leave the stage—would he allow Washington to claim credit for his fall? Nor could a Democratic Administration afford to reach out to Castro politically even if it wanted to. Here's where summeers could perform a service as brokers.

The lengths to which the U.S. went in Haiti to accommodate murderous dictators suggests there might also be flexibility in easing Castro out. Here the summit partners can take the initiative. Washington has to hold back because Castro's remaining support is based chiefly on anti-Americanism and pride.

A regionwide call for Cuban elections and regionwide aid to ease the transition can lead to a lifted embargo and an agreement on outstanding issues in exchange for elections. False pride on both sides is blocking Cuba from freedom and prosperity. The Latin partners can ask the U.S. to take these wise steps and they can urge Castro to accept. All can save face and still attain their goals.

Rudi Dornbusch is professor of economics and management at Massachusetts Institute of Technology.

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BY GENE KORETZ

EUROPE'S EXPORT BOOM IS HOT...

Capital goods lead the rally

Not too long ago, the consensus view was that Europe would crawl out of recession. Instead, European economies have vaulted past the starting gate, posting 10% growth in industrial output in the second quarter and putting new upward pressure on interest rates.

The big growth catalyst has been export demand. Salomon Brothers Inc. says exports to non-EU countries by France and Germany are running 8% and 15%, respectively, over 1993. And in Italy, Britain, Spain, and Sweden, which experienced currency depreciations a few years ago, they are up 12% to 27% after soaring 23% to 33% in 1993.

Demand is up significantly from North America, Latin America, Asia, and Eastern Europe—particularly for capital goods. And export orders continue to improve, reports Salomon.

...BUT NOT ITS AUTO INDUSTRY

Demand may be sputtering

Despite buoyant exports, European economies seem in little danger of overheating. Consumer demand is still sluggish in many countries, and the bell-weather automobile industry is headed for a correction.

When plunging European sales caused a huge inventory pileup a few years ago, European auto makers slashed output—depressing the entire industrial sector. By early this year, however, production was rebounding. Economist Paul F. O'Brien of J. P. Morgan & Co. estimates that auto output accounted for at least half of the second quarter's overall industrial production gains.

Unfortunately, European auto demand has been less resilient. It picked

up earlier this year, partly because of government incentives in France and Spain. But these programs seem to be running out of steam, and tax hikes have cooled demand in Britain. Overall, Western European car sales are up less than 5% so far this year, compared with a 19% rise in vehicle output (chart).

The likely upshot is a slowing in European auto production. With exports still booming, that should result in a more moderate, sustainable expansion.

A MESSAGE IN U.S. MONETARY DATA?

Not much sign of inflationary fuel

A decade ago, the weekly reports on the money supply made headlines. Today, almost no one mentions the subject—least of all the Federal Reserve, which has concluded that financial deregulation has all but severed the once-predictable linkages between monetary variables and the economy.

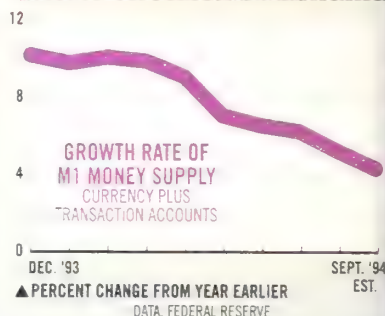
Still, economist William V. Sullivan Jr. of Dean Witter Reynolds Inc. thinks the recent behavior of the monetary variables may have something to say about the current outlook for the economy and inflation. "Almost across the board," he declares, "the picture is one of significant monetary restraint."

Sullivan notes that nonborrowed bank reserves, the monetary aggregate the Fed controls directly via its open market operations, have contracted at a 5.5% annual rate over the past six months after rising at a 7.3% pace in the prior six months. And in August, the three key definitions of money, M1, M2, and M3, contracted in the same month for the first time on record.

Growth of all three of these monetary aggregates has been slowing sharply on a year-over-year basis since early 1994. But the most telling change has been in M1, the narrow money supply consisting of currency, checking accounts, and the like, whose growth fell to an estimated 4.3% in September (chart) from 10% earlier in the year.

Although M1 has been regarded as a less reliable measure of the money supply than M2 (which adds savings accounts and small CDs to M1) for at least a decade, Sullivan notes that it has had a decent record as a leading indicator in recent years. After its annualized growth rate surged from 8.6% at the end of 1991 to 14.2% at the end of 1992, the economy took off. And its sharp slowdown in the first half of 1989 was

MONEY GROWTH IS PLUNGING



followed by a recession a year later.

"If the monetary aggregates are telling us anything at all," says Sullivan, "it is that fears of rising inflation and an overheated economy are exaggerated."

TEENAGE MOMS GET A BUM RAP

Their age isn't the problem

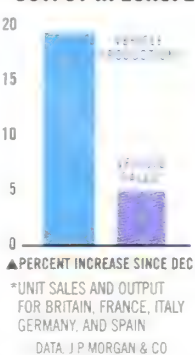
The children of teenage mothers often start life with several strikes against them. Not only do they tend to lag behind children of older mothers in tests of cognitive, social, and emotional development, but they are also far more likely to do poorly in school.

Some experts claim this isn't simply because most teenage mothers come from disadvantaged backgrounds but because teenagers, regardless of class, don't make ideal mothers. Teenagers are thought to be less emotionally mature and sensitive to their infants than older women, and to possess fewer parenting skills.

To test this view, Arline T. Geronimus and Marianne M. Hillemeier of the University of Michigan and Sanders Korenman of the University of Minnesota compared the developmental scores of children of sisters who experienced their first births at different ages. The sisters were of varying family backgrounds, but one in each set became a mother as a teenager, and the other later in life.

The study found no significant difference in measures of child development between children of teenagers and the cousins whose mothers postponed childbearing. The results suggest that the woes afflicting the offspring of many teenage mothers are due to the mothers' disadvantaged status rather than their age. In other words, getting poor girls to postpone having babies is unlikely to help their future kids if the own social and economic problems aren't tackled at the same time.

AUTO SALES LAG OUTPUT IN EUROPE



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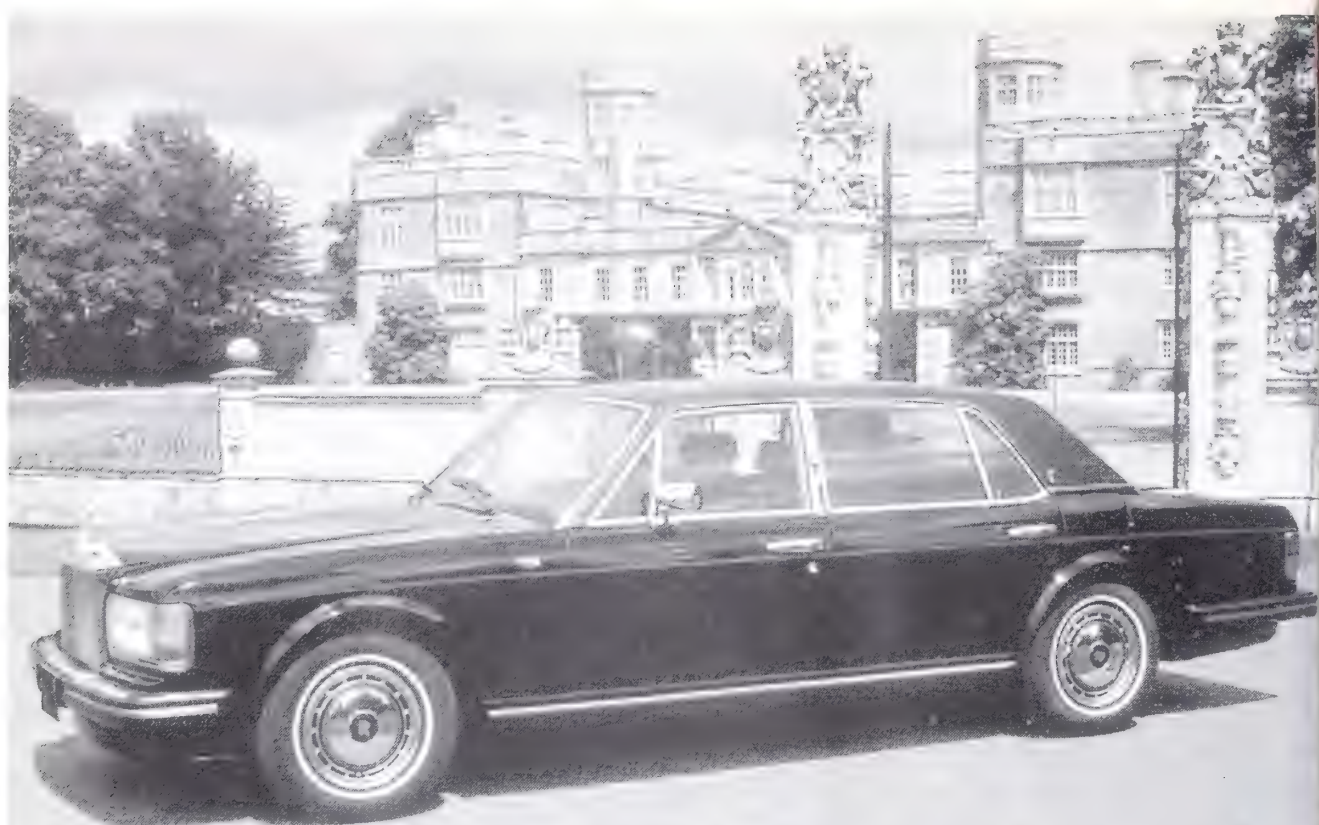
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AN CONSUMERS TAKE A PUNCH AND KEEP ON SPENDING?

U.S. ECONOMY

Chief executives are starting to get edgy. Perhaps they sense something that is not yet clear in the economic data: The Federal Reserve's aggressive rate hikes this year are going to take a bite out of economic growth.

Business confidence fell in the third quarter, says the Conference Board. Although the CEOs seem satisfied with the current economic climate, they are decidedly less optimistic about the future. Fewer than 35% of those polled expect business conditions to improve in the next six months, a sharp drop from nearly 55% in the second quarter, and the small 10% portion expecting things to get even doubled to a not-so-small 20%.

Are their worries real? The answer lies with consumer spending. Higher rates have clearly cut into housing activity, and they have killed the boom in refinancing. Both supplied the extra fuel for the more than 4% surge in consumer spending—especially for durable goods—last summer, fall, and winter.

Now, rate hikes are taking cash out of homeowners' pockets because adjustable-rate mortgages cost more. And credit is now more expensive at a time when household savings are historical-

low. How consumers bear up under conditions that are less supportive of spending than those earlier in the year is the key to the outlook.

FOR CONSUMERS

are hanging in there, buoyed by gains in jobs and incomes. Both housing and consumer spending showed strong gains in August. Real consumer outlays rose by 0.7%, and September retail sales are expected to post another modest gain (The Week Ahead, p. 249). Moreover, August sales of new single-family homes jumped 9.7%, to an annual rate of 703,000.

The housing gain was led by a suspiciously large 82.1% increase in sales in the Northeast. Indeed, the overall August gain was likely a last rush by buyers. Mortgage rates fell in July by one-quarter of a percentage point, touching a flurry of mortgage activity. Since then, however, they have headed north once again, and mortgage applications have dropped sharply (chart). This decline suggests that home sales likely retrenched in September. Consumer spending in August was powered mostly by a 3% rise in vehicle sales. That increase wasn't repeat-

ed last month. Sales of U.S.-made cars and light trucks dipped slightly to an annual rate of 12.7 million in September from 12.9 million in August. So far in the third quarter, real consumer spending is growing at a 2.5% annual rate. That's above the 1.3% crawl of the second period, but well off the pace of the previous three quarters.

How consumers perform in coming months is important to retailers because of the coming holiday shopping season, and to manufacturers since consumer goods account for nearly three-fifths of the output of final products.

Right now, factories are humming, although that partly reflects the auto industry's effort to catch up after its summer shutdowns, which is giving activity a temporary lift. Manufacturing CEOs are still upbeat about the outlook, says the Conference Board, and the nation's purchasing managers agree. Their index of industrial activity rose two points in September to 58.2%, the highest level of the year.

The purchasers said orders, production, and employment all grew at a faster rate than in August, and that prices paid for materials accelerated (chart). Their indexes of prices and employment both hit six-year highs.

Brisk factory activity was a big reason for the 0.5% increase in the August index of 11 leading indicators. A surge in consumer-goods orders accounted for half of the gain, but Detroit's catch-up fueled the order rise. The jump in the August index followed four months of little gain, but it looks more like a one-time bump than a signal of faster economic growth.

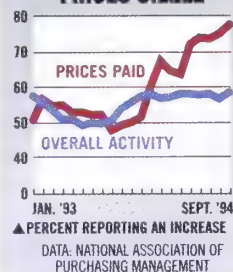
THE CONTINUATION

of factory activity at its recent pace will depend critically on the success of the holiday season. In last year's fourth quarter, consumers splurged, boosting their spending at a 4% rate, with a 15.6% jump in outlays for durable goods, setting output in motion.

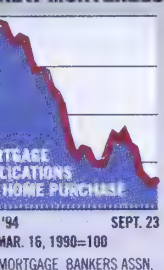
This fourth-quarter, spending will be more subdued because consumers don't have mortgage refinancings and ready credit that financed much of the earlier shopping spree. Now they must rely more heavily on income growth. Personal income rose 0.4% in August, or 0.3% adjusted for taxes and inflation. Real disposable income is up 3% vs. last year, less than the 3.5% spending pace.

Interest income, at least, has been helped by the spate

FACTORIES COOK, PRICES SIZZLE



APPLICATIONS NEW MORTGAGES



of Fed rate hikes. Such income is up 5.4% over the past 12 months, a reversal from the 4.3% drop of a year ago. Still, the bulk of personal income—wages and salaries—will depend on the course of employment growth. And hiring is likely to be tempered by the moderation in overall demand.

Clearly, consumers will not play Scrooge this year, but many households' funds will be more limited than they were in 1993. The Mortgage Bankers Assn. reports that because of rising rates, applications to refinance a mortgage are running at one-twelfth the pace of a year ago.

Also, consumers in the first half of 1994 took on installment debt, including credit cards and auto loans, at a rapid pace, increasing their monthly debt payments. But installment credit does not tell the whole story of consumer debt obligations.

FOR ONE THING, the installment-debt data ignore auto leases and home-equity loans—two popular alternatives to traditional loans. According to CNW Marketing/Research, consumers are carrying about \$22.1 billion in obligations for car and truck leases, a near doubling in just three years. More than one-quarter of cars and trucks are leased—the proportion is higher for luxury models.

At the same time, consumers have increased their use of home-equity loans, which totaled \$74.3 billion in August.

When added together, installment credit, home-equity loans, and auto leases will amount to 19% of disposable income this year. That's a much greater burden than the 16.9% ratio of only installment debt to income (chart).

Are households feeling the pinch from too much borrowing? So far, the evidence is mixed. The American Bankers Assn. reports that the delinquency rate on consumer loans, including home equity, credit-card balances, and auto loans, fell to a historic low in the second quarter.

But the mortgage bankers say that mortgage delinquency rates have risen for two straight quarters. One problem: The two-percentage-point rise in short-term rates over the past year has added an extra \$120 to the monthly payments of a \$100,000 adjustable-rate mortgage. And because it takes time for mortgages to adjust, the squeeze will worsen in 1995.

In fact, the full brunt of the Fed's rate hikes since February 4 will not hit the economy until next year—and yet another half-point increase before yearend is expected. Perhaps corporate chieftains are beginning to realize that the fight against inflation always comes at a cost.

CONSUMERS' RISING DEBT BURDEN



▲ PERCENT OF AFTER-TAX INCOME
*INSTALLMENT DEBT PLUS AUTO LEASES AND HOME EQUITY LOANS **BNA
DATA: COMMERCE DEPT., FEDERAL RESERVE, CNW-MARKETING/RESEARCH, BNA

ASIA

JAPAN'S RECOVERY IS STRUGGLING TO FIND ITS LEGS

Bank of Japan Governor Yasushi Mieno sounded upbeat about Japan's economy at an Oct. 2 meeting of the International Monetary Fund. Maybe too upbeat.

Clearly, Japan's prospects are improving. The government's tax reform plan, which extends this year's ¥5.5 trillion (\$55 billion) cut in income taxes into 1995, ensures at least a mild upturn. But so far, the recovery is struggling to find its legs, held down by structural drags from excess capacity, debt deflation, and *endaka*—the super-strong yen.

After a promising 4% jump in first-quarter real gross domestic product, second-quarter GDP

dropped a larger-than-expected 1.6%, as consumer spending and business investment both fell. 1994 growth will strain to reach 1%, before reaching 2.5% to 3% in 1995.

Consumer spending must lead the recovery, but households are still hesitant to spend. Sales at large retail stores in August fell 1.7% from a year ago, deflating the optimism from July's rise. August vehicle sales, measured by new registrations, were more upbeat.

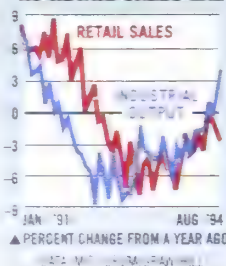
Consumer demand will pick up, as purchasing power strengthens in response to tax cuts and negligible inflation. The Tokyo consumer price index in September was up only 0.1% from a year ago.

Also, the labor markets will stabilize, but grudgingly. In August, the jobless rate held at 3%, a seven-year high, while the ratio of job offers to applicants was near a seven-year low.

Manufacturing, at least, is on solid ground, thanks to stepped-up foreign demand in the U.S. and in Europe. Industrial output, about 40% of GDP, surged 3.8% in August from the previous month, far greater than expected. And the ratio of inventories to shipments fell to a three-year low, a good omen for future output.

Manufacturers are adjusting to the strong yen by cutting hiring and moving operations offshore. That strategy helps profits, but it undermines domestic demand, which is the key to a self-sustaining recovery.

OUTPUT RECOVERS, AS RETAIL SALES LAG



▲ PERCENT CHANGE FROM A YEAR AGO
DATA: MITI, CHAN, JAPAN HILL



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clients, teamwork, individual
excellence, creativity and



integrity. In 1994, we take
pride in how we got here,
and we pay tribute to
the beginnings that have
always inspired us. It's
a foundation we intend to
build on in the years to come.

'THE RONALD REAGAN OF NEW JERSEY'

Christie Whitman's formula is being widely imitated. Does it work?

Christine Todd Whitman isn't running for governor of Connecticut. Or Maryland. Or New York. Or even South Dakota. But from listening to the campaign rhetoric in those states, you'd think she was at the top of each ballot.

Whitman, governor of New Jersey, has become an icon in gubernatorial races across the country. The massive tax cuts she promised in her 1993 election campaign have become the rallying cry for Republicans—and a few Democrats—seeking state houses this year. Whitman ascribes the popularity of her message to the fact that she acted quickly, that she gave her cuts clout by making them retroactive, and that being a woman gives all her actions high visibility. But there's more to it than that: Despite intense sniping by critics, a Sept. 25 poll by Rutgers University's Eagleton Institute of Politics shows her winning a 52% positive rating from voters, higher than her three predecessors at the same stage of their terms.

MIXED RECORD. Little wonder, then, that many Republicans and Democrats alike are gearing up to make Whitman-style tax cuts a key issue in their own campaigns. The fracas going on in Connecticut is a good example. Republican John Rowland wants to repeal the \$2.6 billion-a-year state income tax. Democrat Bill Curry, who says Rowland can't possibly pay for his tax cut, has countered with a plan to cut the property tax by \$1 billion. "He's pointing to Christie Whitman. So are we," says Cur-



SELLING THE VIS
Whitman's char
has won the
public's goodwill

ry spokesman Roy Occhiogrosso. Parries Rowland: "They can stand behind [former New Jersey Governor] Jim Florio and Bill Clinton. I'll stand behind Christie Whitman all day long."

Despite her popularity, though, Whitman's record so far is mixed. Taking office with state finances in a shambles, she promised a 30% income-tax cut in just three years while keeping the budget balanced. She cut taxes by 15% this year and brought the budget under con-

trol. But she has had to use some fiscal sleight of hand to get there. And she recently conceded that it may take four years to meet her tax-cut goal.

Whitman's most controversial move was to finance tax relief by slashing \$1 billion in state contributions to the public employee retirement fund in fiscal years 1994 and 1995 alone. Nearly half the cut resulted from a decision to stop pre-funding retiree health-care costs. An additional \$80 million was saved by

g the plan's cost-of-living as-
ons to 2.4% from 3%. "It's really
other way of going into debt,"
even D. Gold, director of the
for the Study of the States.
Whitman also has cut state spending
education—the largest single drain
property taxes—by more than
million. And she has continued a
on aid to local government be-
der Florio. That has generated
at hikes in local property taxes
more than offset her income-tax
deed, local property taxes in the
ave skyrocketed, though it's un-
whether budget cuts were the

other states cited by GOP tax-cutters.
Michigan cut taxes by over \$1 billion
last year, and Massachusetts slashed
taxes by 4.8% and local aid by \$270 mil-
lion. But in both cases, according to Mi-
ami University political scientist Michael
A. Pagano, local taxes and fees explod-
ed through fiscal years 1992-94, as state
aid was curbed.

So far, Whitman's likeable personali-
ty has helped her counter such doubts.
"She's the Ronald Reagan of New Jer-
sey," says Rutgers University political
science professor Ross K. Baker. Even
her admission that income-tax cuts will
take longer than promised hasn't hurt

the other is Parris Glendening, county
executive of Prince George's County, a
Washington suburb.

In a heavily Democratic state, Glen-
dening is running a traditional Demo-
cratic campaign. He's calling for more
spending on education, public safety,
and economic development, while back-
ing only modest business tax cuts.
Sauerbrey is running within 10 points of
Glendening because, echoing Whitman,
she proposes to slash taxes by 24%, or
\$2 billion, over four years. "What has
made this issue catch fire is that it
bridges the gap between controlling
government spending and a positive ef-
fect on the taxpayer," Sauerbrey says.

25% SOLUTION. Taking a bonbon from
the Whitman sampler, Sauerbrey insists
she can trim revenues while building
more prisons, preserving current aid to
local governments, and avoiding cuts in
other essential government programs.
Her antitax stance has put Glendening
on the defensive. Concedes a Democrati-
c campaign aide: "If all people know
about her is that she wants to cut their
income taxes, it's not surprising that
they react favorably."

Still, Glendening is a rare Democrat
in that he—so far, at least—has refused
to play the tax-cut game. In New York,
Democratic incumbent Mario Cuomo
calls opponent George Pataki irrespon-
sible for not proposing serious spend-
ing cuts to offset his promised 25% in-
come-tax cut. But with the race
extremely tight, the four-term gover-
nor is expected soon to unveil a modest
\$1.5 billion tax cut of his own.

Other Democrats are going further.
Consider South Dakota, where both GOP
candidate Bill Janklow and Democrat
Jim Beddow have proposed 30% reduc-
tions in the property tax. Beddow
sounds almost like a Republican when he
says the tax issue has galvanized voters:
"It's more than financial. It has become
a crisis of confidence over whether gov-
ernment can get anything done."

That's the message that Whitman has
been riding so successfully in New Jer-
sey, just as Michigan's John Engler and
Massachusetts' William Weld did before
her. Now, if she can deliver on the rest
of her promises, she might find her way
onto the GOP's national ticket in 1996.
After all, a socially moderate, fiscally
conservative woman might be just what
the GOP will need if it nominates a hard-
right Presidential candidate. Whatever
her future, her imitators hope Whit-
man's vision is as appealing outside New
Jersey as it has been inside.

*By Howard Gleckman in Washing-
ton, with Judy Dobrzynski in New York*

N WANNABES

Gubernatorial candidates hoping to
win votes with promises of tax cuts:

W/SOUTH DAKOTA The Democrat says he would cut property taxes by 30% over
a cost of \$132 million. Promises to freeze spending at current levels, restructure
and review sales- and property-tax exemptions.

ATAKI/NEW YORK A Republican, he proposes cutting income taxes by 25% over
a cost of \$5.6 billion. Says he would cut state jobs and consolidate agencies, limit
ases in spending to inflation.

LAND/CONNECTICUT Says he would repeal the state income tax, cutting rev-
5 billion a year. The Republican would offset \$400 million of the cut by reorganiz-
ent and says increased economic activity would make up the rest.

ERBREY/MARYLAND Another Republican, she favors a 24% cut in the state in-
set by a freeze in most government spending.



CUTS? GOP challenger Pataki may prod Cuomo to offer tax breaks

According to a study by *The*
/, a Hackensack (N.J.) newspa-
families in 85% of northern New
communities surveyed will face
rall tax hike this year, with prop-
axes overwhelming modest in-
tax cuts. Whitman counters that
omplaints are "a false issue,"
drummed up by posturing op-
s. Cities and towns, she insists,
to cut, too."
, a similar pattern shows up in

her. "The Democrats are making it an is-
sue, but the people—and I've talked to
a lot of them—don't care whether it's
four years or three," Whitman says.

But will the Whitman message play
so well elsewhere? The starkest test is
in Maryland, where a supply-side Re-
publican and a liberal Democrat are bat-
tling it out in a surprisingly close gov-
ernor's race. In one corner, there is
House Republican leader Ellen R.
Sauerbrey from northern Maryland. In

CONGRESS

BACKS TO THE WALL, DEMOCRATS COME OUT SCRATCHING

They're showing they can draw blood just as well as the GOP

Facing an unforgiving electorate that seems ready to string them up, Democratic incumbents who have been pushed to the limit are suddenly showing surprising new vigor in their campaigns.

Their strategy: Take a page from the Republicans' law-of-the-jungle playbook and get down and dirty. Most Democrats—particularly incumbents—have come to a common conclusion, says G. Terry Madonna, a pollster at Millersville University in Pennsylvania: that the Democrats have to “crucify their opponents” in order to win. And that’s likely to produce “the most vicious three-week campaign in history,” declares Republican Representative Newt Gingrich of Georgia.

Why the sudden turn toward the nasty? The Democrats hope to fend off what could be their biggest midterm drubbing since 1966. If the worst were to happen, Republicans might seize the Senate and build a ruling conservative coalition in the House. But tacticians are hoping the survival strategies may succeed in pulling enough imperiled incumbents out of hot water by the Nov. 8 election to salvage Democratic control of the Senate and hold House losses to an acceptable—though painful—25 seats.

“PHONY CLAIMS.” To be sure, negative campaigning isn’t the Democrats’ only new gambit. Ideological camouflage also is particularly big this year. And many Democrats are recasting themselves as “outsiders” who fight for Joe Average against entrenched interests—or are developing jungle fever, a selective form of amnesia that leads a Democrat to forget everything about Bill Clinton.

But blitzing opponents with negative attack ads is more often than not the order of the day. Notes Democratic me-



A TEST FOR TED: Using negative ads for the first time

dia consultant Mark McKinnon: “Nothing focuses your attention like the gallows.” In Pennsylvania, incumbent Senator Harris Wofford is skewering Republican Rick Santorum on issues such as pocketing a congressional salary increase after promising not to and employing his House staffers to raise campaign funds. And in Virginia, Senator Charles S. Robb is slashing challenger Oliver North for lying to Congress and expressing pride in the Confederate flag.

The campaign of Massachusetts Senator Edward M. Kennedy, who finds himself in a tough battle with GOP newcomer Mitt Romney, shows how rough

things have gotten. Kennedy has launched attack ads for the first time in his 32-year political career. His seven negative TV spots accuse Romney, a Republican venture capitalist, of deceiving voters with “phony claims” about his business record. Kennedy even has raised questions about alleged racism in Romney’s Mormon Church. Pollsters say that thanks to his \$9 million assault, Kennedy may yet win. “To salvage the race, they’ve got to go negative,” says Romney media consultant Rick Redburn. “The only way they’re going to win is if the public thinks worse of Mitt than of Ted Kennedy.”

GLAD-HANDING. Other Democrats are using softer tactics. Some are styling themselves as grassroots defenders of the little guy. In Tennessee, liberal Senate Budget Committee Chairman Jim Sasser is calling himself “the taxpayer’s watchdog” against government waste. And he has wrapped himself in a homespun quilt of small-town values: Sasser’s TV ads trumpet the incumbent’s devotion to “hard work, honesty, [and] respect for your neighbor.” He holds a tenuous lead over surging GOP challenger Bill Frist, a heart surgeon who has made a virtue of his complete lack of political experience.

With Republicans doing well by focusing on national concerns such as public dislike for Clinton and disgust with Congress, many Democrats are trying to focus on local issues. In New Jersey, for instance, incumbent Senator Frank Lautenberg isn’t talking about health-care reform. Instead, he’s hammering at issues such as his fight to keep “New York sludge” out of the Garden State. Once thought to be in deep trouble, Lautenberg is now a slight favorite over Republican Garabed Haytaian.

Of course, it’s hard for some Democrats to shake off their national trappings. A notable example: Thomas Foley, who could become the first House Speaker turned out by voters since 1856.

ELECTION '94

A CLINTON QUAGMIRE

If the GOP takes the Senate, the President’s most loyal supporters will be replaced:

COMMITTEE	OLD CHAIR	NEW CHAIR
FINANCE	Pat Moynihan (D-N.Y.)	Bob Packwood (R-Ore.)
APPROPRIATIONS	Robert Byrd (D-W.Va.)	Mark Hatfield (R-Ore.)
LABOR & HUMAN RESOURCES	Ted Kennedy (D-Mass.)	Nancy Kassebaum (R-Kan.)
BUDGET	Jim Sasser (D-Tenn.)	Pete Domenici (R-N.M.)
BANKING	Don Riegle (D-Mich.)	Alfonse D’Amato (R-N.Y.)
FOREIGN RELATIONS	Claiborne Pell (D-R.I.)	Jesse Helms (R-N.C.)
ARMED SERVICES	Sam Nunn (D-Ga.)	Strom Thurmond (R-S.C.)

0-year incumbent is struggling to
nce skeptical eastern Washington
tients that he's in touch. But spir-
lad-handing may not overcome Re-
an attorney George Nethercutt's
e-digit lead.

hough party leaders are discour-
g the tactic, many Democrats are
ing away from Clinton. In Okla-
Representative Dave McCurdy,
erate running for an open Senate
boasts of his independence from
esident—even though the two are
me collaborators in the centrist
eratic Leadership Council. "B.C.
t stand for Bill Clinton," crows

National Republican Congressional
Committee Chairman L. William Pax-
on (R-N. Y.). "It stands for ball and
chain."

Some Democrats have even disowned
the 1993 budget deal that is the center-
piece of Clintonomics. New Jersey's
Lautenberg has made television com-
mercials that have a stark message:
"With taxes killing New Jersey, Frank
Lautenberg opposed his own party and
voted against taxes." Those would have
been Bill Clinton's tax increases, of
course.

That's a little embarrassing, needless
to say. But the Administration is willing

to let Democrats suggest just about any-
thing in order to steal a victory this
year. And for good reason: White House
operatives shiver at the prospect of a
hostile Senate led by the acerbic Bob
Dole and Clinton-bashing committee
chairs (table).

By adapting to the punishing reality
of Campaign '94, some prominent Demo-
crats are going to escape extinction. But
a sufficient number of incumbents will
perish to bring the Republicans' dreams
of congressional control a step closer to
reality.

*By Richard S. Dunham in Washing-
ton, with Mark Maremont in Boston*

VOTER BEWARE: READ THE FINE PRINT

hink congressional campaigns are
dirty? Check out the high-stakes
fights over state ballot initia-
tives. From Florida to California,
ers are grappling with measures
issues ranging from gambling to
alth care. And the stakes are enor-
ous—particularly for business. In
California alone, the
acco industry

nds to win back as
uch as \$365 million in annual cigar-
e sales if it can push through a
asure easing smoking restrictions.
In another California initiative,
business is up in arms over Proposi-
n 186, which would create a sin-
-payer, Canadian-style health-care
tem in the state—financed with
0 billion worth of new income, pay-
l, and cigarette taxes. There's

re. Companies are worried by yet
other Golden State initiative—this
e, likely to pass. Proposition 187
uld deny services to undocumented-
immigrants and require state em-
ees, such as teachers, to report
pected illegals to authorities.
wlett Packard Co., for one, has
ne out against the initiative. "We
nk it's a racist measure. It makes
pegoats out of women and chil-
n for California's economic prob-
s," says a company spokesman.

RACIST. And California, as usual, is
rendsetter. Other states are ex-
ected to follow the state's lead with
ilar measures on undocumented
rkers. That's because Governor
te Wilson has given his once-mori-
nd campaign a huge boost by loud-
endorsing the measure, which vot-
favor by a margin of 2 to 1,
ording to the latest Field Poll.
d California State Treasurer and
mocratic hopeful Kathleen Brown,

who has called Proposition 187 "ugly
and racist," may have dealt her can-
didacy a death blow by strongly op-
posing it.

Across the country, the fight over
legalized gambling is equally as bit-
ter, critics contend. In Florida, Colo-
rado, and Missouri, for instance,
gaming interests are
spending about \$16 mil-
lion total to push legal-
ized gambling, says the National Co-
alition Against Legalized Gambling.
The campaign's main backers in Col-
orado: a group called Committee for
Better Schools, funded mainly by
business interests.

Big Tobacco, meanwhile, is fight-
ing antismoking measures with simi-

lar camouflage campaigns. Philip
Morris Cos. is bankrolling a group
called Californians for Statewide
Smoking Restrictions. With a name
like that, the group had no problem
signing up 600,000 health-conscious
voters to put the measure on the bal-
lot. The hitch: The measure would
abolish tough local ordinances that
prohibit smoking in public places and
replace them with less-stringent
statewide regulations.

Critics charge that the measure
has a good chance of winning only
because it is intentionally confusing.
In 1994, that's the plan: When it
comes to ballot initiatives, things
are rarely what they seem.

By Eric Schine in Los Angeles

ELECTION '94

PEOPLE POWER

Some key issues being voted on in
state referendums across the U.S. this fall:



IMMIGRATION In a move that could presage similar laws in other states, California
is expected to pass a measure that will deny state services—including health care
and schooling—to undocumented immigrants.

SMOKING Arizona and Colorado have an even chance of passing stiff new tobacco
taxes. In California, Philip Morris is financing a campaign to replace local antismok-
ing ordinances with a looser statewide standard.

GAMBLING Florida, Missouri, and Colorado are considering initiatives to legalize or
extend legalized gambling.

HEALTH CARE Though unlikely to pass, California's Proposition 186 would mandate
statewide universal health coverage.

TRADE

WHY WASHINGTON BACKED DOWN AT THE MIDNIGHT HOUR

Fearing financial fallout, the U.S. made a tepid deal with Japan

"I used to think if there was reincarnation, I wanted to come back as the President, the Pope, or a .400 baseball hitter. But now, I want to come back as the bond market. You can intimidate everybody."

—Presidential Adviser James C. Carville, quoted in *The Agenda*, by Bob Woodward

There's no need to explain Carville's words to U.S. trade negotiators. The market's shadow dogged their every move last month, as they stared across the table at their Tokyo counterparts, hoping to hammer out the biggest Japanese market-opening agreement in history.

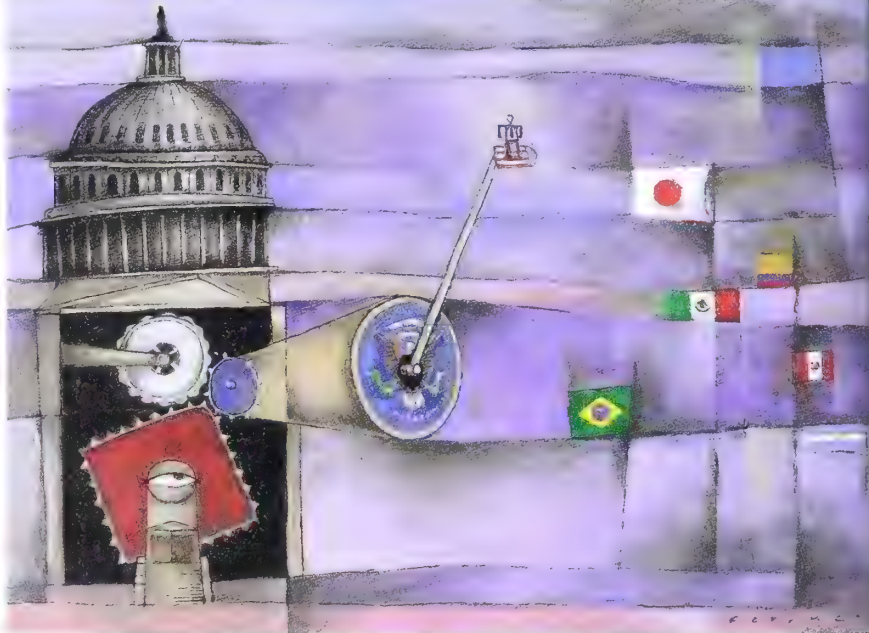
When the breakthrough came Oct. 1, there was relief but no euphoria. A face-saving compromise allowed both sides to declare victory. The financial markets were calmed. But the deal will do little to reduce the \$60 billion trade imbalance between the world's two largest economies.

Japan agreed to "significant increases" in government procurement of foreign medical technology and telecommunications but with no timetables and no definition of "significant." Both sides extended negotiations for another 30 days on opening Japan's market for flat glass. Tokyo also agreed to end a skewed deregulation of its insurance industry, which U.S. underwriters claimed was crimping even their 2% of the market. On autos and auto parts, which account for 60% of the U.S. trade deficit, little progress at all was made. And U.S. Trade Representative Mickey Kantor backed away from the so-called Super 301 section, the toughest provision of U.S. trade law.

"A REALITY." American business praised the results as a step forward—but not a major improvement. "You are going to see this kind of outcome from now on," says C. Michael Aho, senior international economist for Prudential Securities Inc. "The sword the U.S. brandishes is a lot duller than it used to be."

If anything, the deal looks strikingly similar to one that Bill Clinton refused to cut with former Prime Minister Morihiro Hosokawa last February. But

that was before investor jitters over the collapse of the so-called framework talks sent the dollar plunging against the yen, upset international bond markets, and helped send U.S. interest rates upward. Now, concedes one senior Administration official, financial markets have become powerful players in trade: "It's simply a reality now, and it isn't going away."



"You are going to see this kind of outcome from now on. The sword the U.S. brandishes is a lot duller than it used to be"

Up until the last moment in the Japan talks, the Administration had threatened to resort to Super 301. But participants on both sides say Japanese negotiators repeatedly raised the consequences of more friction between the U.S. and Japan, pointing out that frightened markets could propel the yen through the roof. Tokyo also repelled the U.S. push for numerical signs of progress by stressing the widespread disdain Asian countries have for what they see as "managed" trade. In the end,

the Clintonites backed down. The log With midterm elections looming, w set off another financial crisis?

An unsatisfactory end to this round talks with Japan is just the start of Clinton's troubles on the trade front. On Oct. 5 the House postponed a final vote on the General Agreement on Tariffs and Trade deal until Nov. 29—well after the midterm election. And the President is heading to world trade conferences in Indonesia in November and Miami in December without "fast-track" authority to limit congressional meddling in future trade deals. Suddenly, "Clinton's trade policy in general is in trouble," says Ward Workman, vice-president of the U.S. Chamber of Commerce.

The situation is bitter fruit for Clinton's trade warriors, who came into o

fice vowing to be more assertive in trade policy than the Reagan and Bush Administrations—particularly with Japan. "We took a larger step than some people thought we would take," says National Economic Council head Robert E. Rubin. In the end, though, the Clintonites may have been willing to take on Tokyo, but they couldn't tough it out with the financial markets.

By Douglas Harbrecht, with Paul Magnusson, in Washington and Robert Neff in Tokyo

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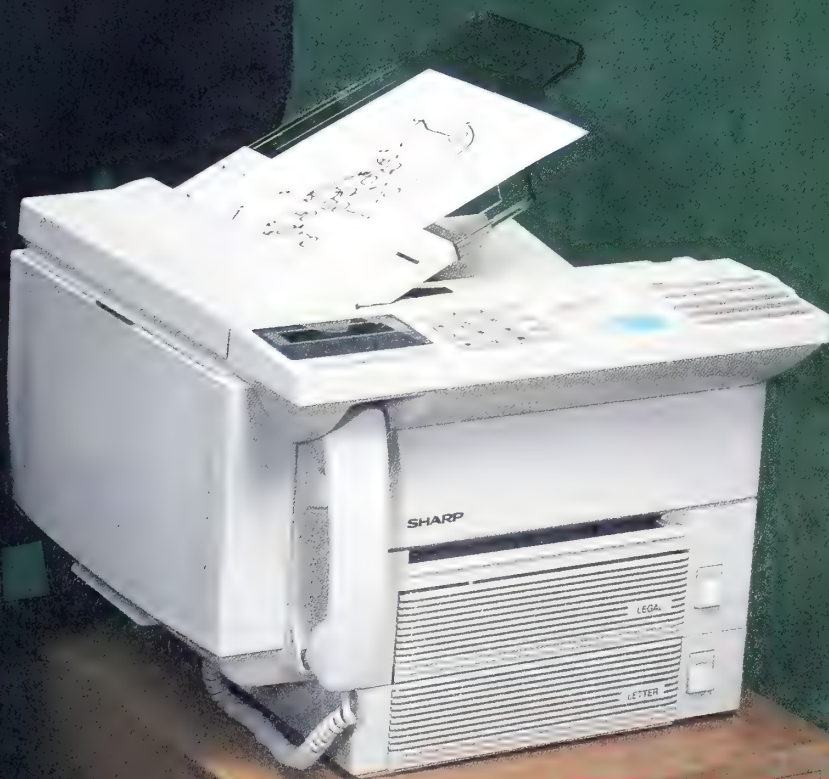
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AIRLINES

USAIR'S FLIGHT PLAN LEAVES LITTLE ROOM TO MANEUVER

Facing a storm of red ink, it is moving to cut labor costs

As the Boeing 737 taxis around O'Hare International Airport's tarmac, a flight attendant runs through the usual safety spiel: "To release your seat belt, pull up on the metal bar..." Mundane stuff—but these passengers, most of them business travelers, are paying close attention. Heads jerk up from magazines to note the plane's six emergency exits.

This is USAir Flight 1245 from Chicago to West Palm Beach, Fla., via Pittsburgh. Three weeks earlier, the same flight—then called 427—plummeted to the ground, killing all 132 people on board. "Since then, I find myself paying attention to everything when I fly," says one passenger, Fred D. Esker, an engineer for DuPont Filaments. On the morning flight to Chicago, a woman orders a Bloody Mary—to calm her jangled nerves, she says.

HEADWAY. The nation's No. 6 carrier has seen happier times. It has lost \$2.4 billion in five years and has spent four months in contentious negotiations with unions aimed at cutting \$500 million from its annual wage bill. Passengers have been shaken by a string of crashes, Flight 427 only the most recent.

People are still flying USAir. The airline's traffic was up slightly in September from a year before, though the gain was less than other carriers'. The airline's financial position, moreover, will remain sound through yearend, allowing time to resolve its labor talks—

which, it appears, finally are making headway.

Clearly, the negotiations are critical. USAir Group Inc.'s operating costs are the highest in the industry—some 56% higher than leader America West Airlines Inc., according to consultants Avitas Inc. At the same time, debt accounts for 80% of total capital, loading the company with \$260 million a year in interest. Lowering wages would allow it to pay down debt—and to compete against Southwest Airlines Co. and Continental Lite, which are both invading its markets. And British Airways PLC, which paid \$400 million for 24.6% of USAir, could come forth with another \$450 million if the carrier turns itself around.

The sticking point has been a demand by the Airline Pilots Assn. (ALPA) that employees receive 25% of USAir's stock and a board seat in return for wage concessions. Now, both sides appear to be giving a bit—prompted in large part, say sources in both camps, by a sense of urgency created by the Flight 427 catastrophe. "It certainly increased the seriousness

FAR FROM PURR-FECT: A string of crashes has left passengers jittery

of the negotiations," said an adviser to one union.

How serious are they now? On Sept. 29, USAir announced that it would postpone \$19.2 million in quarterly preferred dividends to British Airways and Warren E. Buffett's Berkshire Hathaway Inc. The move was meant to "show the unions that the company's investors are willing to share some of the pain in the restructuring process," says Henderson Orme, airline analyst at NatWest Securities Corp. But Wall Street didn't think much of it. USAir's stock fell 20% on the news, to \$4, as analysts raise the specter of bankruptcy and Standard & Poor's lowered its ratings on most of the airline's debt.

GALLOWS HUMOR. For the short term, at least, USAir's balance sheet is relatively strong. With operating cash flow at breakeven and \$400 million in cash on hand, it can survive comfortably through December without a labor settlement, analysts say. The airline can borrow about \$200 million against its 288 plane

Over the next few weeks, USAir CEO Seth E. Schofield will try to hammer out an agreement with ALPA. Then, he will attempt to bring the mechanics and flight attendants on board. Employees appear resigned to forfeiting pay. "The good old days of high bucks are gone," says Ron Carter, the 25-year veteran piloting Flight 1245.

If so, USAir could quickly return to financial viability. The danger is that a break in the momentum could shatter

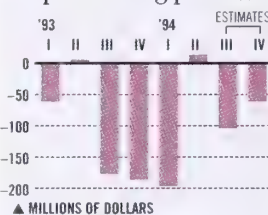
what remains of investor confidence. USAir's stock could drop even more if labor talks fall apart or if the BA follows through with its threat to write off its USAir investment as a loss. Damaging evidence from investigations into USAir crashes, too, could cripple the airline.

In any case, the airline seems destined to live with gallows humor for a while. As Carter lands the airplane in Pittsburgh, he tells passengers "we realize that USAir begins with you." A passenger mutters darkly: "As long as it doesn't end with us." USAir may need more than a financial fix.

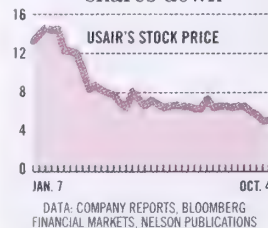
By Keith L. Alexander on Flight 1245

USAIR SCORE

Operating costs are pummeling profits...

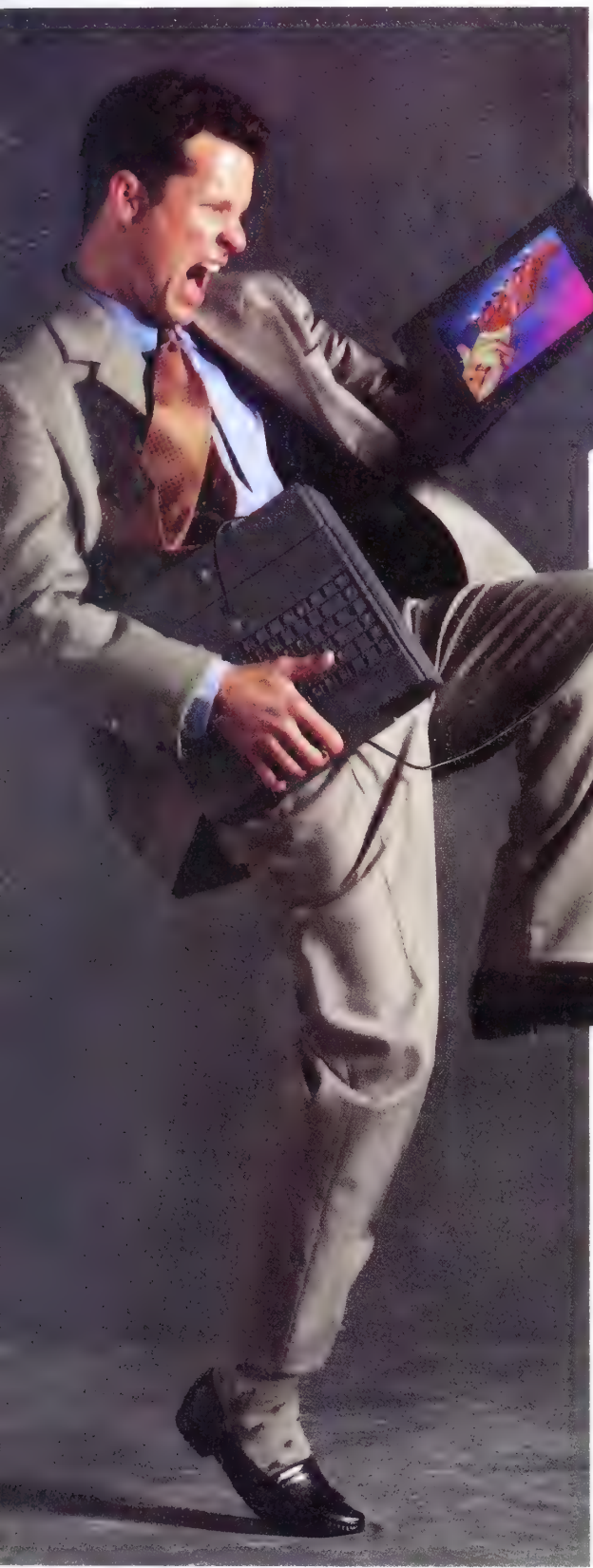


...Sending the airline's shares down



DATA: COMPANY REPORTS, BLOOMBERG FINANCIAL MARKETS, NELSON PUBLICATIONS

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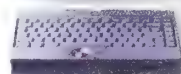
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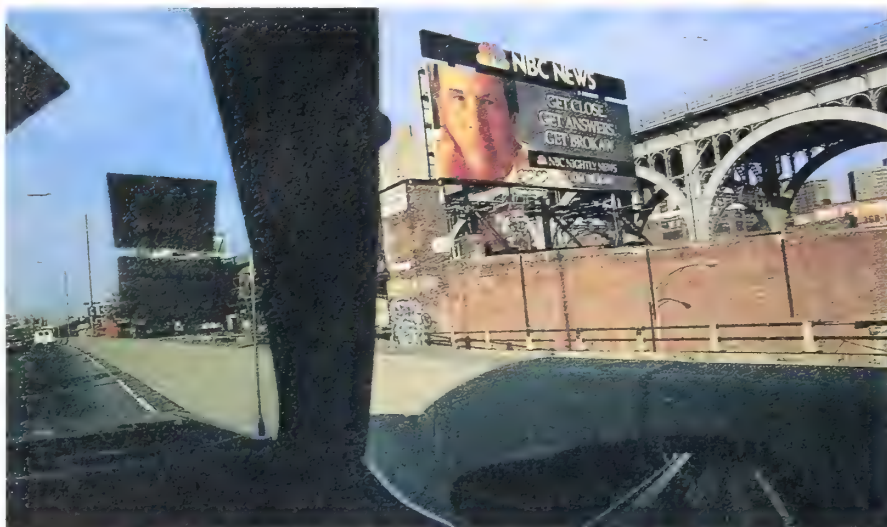


ZENITH
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TELEVISION

THE PEACOCK MAY BE A LITTLE TOO PROUD

GE is wheeling and dealing, but shoppers balk at NBC's terms



STATION IDENTIFICATION: NBC's advertising revenues and ratings have risen

Assets will always find asses," jokes Howard Stringer when he's asked whether CBS Inc. or the other TV networks are about to be sold. For the president of CBS Broadcast Group, known for his puckish wit, that's an easy way to duck the chronic speculation about the future of his network and its rivals, ABC and NBC. Yet Stringer's remark fairly well sums up the recent hysteria in the media business. In the wake of General Electric Co.'s public flirtation with selling NBC, media watchers have burned with questions about network deals: Who's selling, who's buying, and for how much?

The answer is: Nobody. At least, not for now. Despite the steady drip of rumors and frantic jockeying by various players, NBC seems no closer to a deal than when it began discussions with Time Warner Inc. and other companies weeks ago. Meanwhile, Chairman Laurence A. Tisch's insistence on a high price for CBS has put that network out of

reach for most prospective buyers. So far, the great Network Shuffle has been all talk, no walk. And some of the participants look downright silly.

Consider Ted Turner. In a Sept. 27 speech, the Atlanta mogul lived up to his "Mouth of the South" sobriquet by blasting one of his shareholders, Time Warner, for thwarting a deal to buy NBC—likening Time Warner's treatment of him to female genital mutilation. GE Chairman John F. Welch Jr. says the company never had a deal with Turner. And bankers familiar with GE's current negotiations with Time Warner say he is not a factor. In fact, some executives suggest that Turner's outburst may only make network owners less likely to pursue a deal with him.

QUESTION OF CONTROL. Time Warner remains interested in buying 49% of NBC for roughly \$2.5 billion in cash and securities. But its talks with Welch have bogged down over issues of governance. Executives familiar with the negotia-

tions say Time Warner wants to manage the network's entertainment operations, while Welch insists on controlling all aspects of NBC. GE is also unsatisfied with the securities portion of Time Warner's offer.

The logjam illustrates the difficulty of pulling off a network deal. Government regulations bar 100% ownership of NBC for many potential buyers, among them cable operators such as Time Warner and Tele-Communications, and Japanese-owned studios such as Sony and MCA. GE would also like a hefty premium over the NBC's book value of \$3.4 billion. Obtaining such a premium while keeping 51% of the network won't be easy, though. "The prices are very high for any stretch of the imagination," says Michael J. Wolf, partner in charge of media at Booz, Allen & Hamilton.

OFFICE GOSSIP. NBC says all the speculation about imminent deals is useful, because it reaffirms the intrinsic worth of the networks. "In the late 1980s, networks were viewed as dinosaurs," says NBC President Robert C. Wright, "but the value of having a strong national distribution system has been validated." At least, it has been at NBC—where ratings are up sharply in the first two weeks of the 1994-95 prime-time season (table). NBC News is on a roll, with *De line NBC* and *Today*. And the network's operating income should increase 60% in 1994, to \$425 million, says Nicholas Heymann, an analyst who follows GE at NatWest Securities Corp.

Still, there are downsides to Welch's uncharacteristically public parading of NBC. Wright acknowledges that the network's employees are spending much time speculating about changes in ownership. Similar distractions damaged Paramount Pictures Inc. during the protracted bidding war for its parent company.

Given Wall Street's fixation with media properties, Wright says the fuss over NBC is probably unavoidable. Perhaps it's just as well that Larry Tisch insists—publicly at least—that he's not trying to unload CBS right now. With this messy a process, one seller at a time is quite enough.

By Mark Landler in New York, with Ronald Grover in Los Angeles

The Network Shuffle

NBC Is still discussing selling a 49% stake to Time Warner. Talks to sell the network outright to Disney for \$5 billion have ended. Its 12.2 rating* makes it No. 2 in this season's first two weeks.

CBS Scuttled a merger with QVC in July. Chairman Larry Tisch says the network isn't for sale, and CBS denies rumors of talks with Disney. With a weak 11.7 rating, it's in third place.

ABC Just named Robert Iger president. The top network this year, with a 12.4 rating, it has eschewed any big deals so far.

*Each rating point represents 940,000 television households DATA: A.C. NIELSEN CO., BUSINESS WEEK



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COMMENTARY

By David Greising

SPORTS SALARY CAPS: ONE SIZE FITS NOBODY

So this is the golden age of sports in America. In their grab for all the cash they can carry, owners and players have killed baseball's 1994 World Series. They have also put the start of the National Hockey League season on ice. And now they're even threatening to create the first work stoppage in the history of the National Basketball Assn.

Blame NBA Commissioner David J. Stern for all the trouble. The ultimate salesman, Stern during the 1980s convinced sports team owners that the NBA's salary cap was responsible for basketball's remarkable Lazarus act. Never mind Larry Bird, Magic Johnson, and Michael Jordan. In Stern's view, the cap won the day. It ushered in an era of good feeling between players and owners that helped eliminate basketball's image as a loser sport. Franchise values jumped from \$10 million to \$120 million. "We have seen the benefits of working together," says Stern.

DUNCES. It's a message with natural appeal to owners in all sports: Control salaries, and watch profits skyrocket. Sure enough, the strategy has been cross-fertilized to the far reaches of pro sportsdom. Chicago White Sox owner Jerry Reinsdorf, who also owns the NBA Chicago Bulls, was a prime mover behind baseball's salary-cap proposal. And the NHL's proposed "luxury tax" on teams with payrolls above the league standard clearly harks back to Commissioner Gary Bettman's days totting Stern's briefcase. "It's as if there's an outright conspiracy among the owners in the various sports," says Andrew Zimbalist, a consultant to the baseball players' union.

If so, it's a conspiracy of dunces. The salary cap worked once, in very extenuating circumstances: It saved basketball when basketball was moribund. But it's not even working in the NBA anymore. Teams spend more time and money circumventing the



DATED? Sports teams are not alone in their quest for success.

cap than they do trying to fit their payrolls under it. And NBA players could strike this year to force the cap into past tense.

Look around, and there's no reason to believe caps will do any better in other sports. Football's cap is a disaster in its first full season. It created a refugee class of unwanted, highly paid veteran talent during the off season. Already, football pros are talking about eliminating the device during 1999 contract talks.

Baseball's union has sworn to stop the cap before it even arrives. Late in their talks with owners, the players presented a plausible plan that would have "taxed" teams with high payrolls and used the funds to subsidize weaker clubs. The plan—similar to Bettman's current NHL proposal—would have helped meet two major goals of baseball's owners. It would

have created a disincentive to runaway wages and a form of revenue sharing. But a controlling group of hard-line owners, who want nothing less than an outright cap, rejected it out of hand. Good-bye, 1994 World Series.

Bettman, at least, has accepted the fact that a plain old cap won't fly with NHL players, who recognize that, unchecked, their salaries will rise to higher levels with the sport's growth. "They told us from the start that a cap would be unacceptable, so we're trying something else," he says. On Oct. 5, the players rejected Bettman's "luxury tax" proposal and promised to come up with a proposal of their own.

DISMAL SEASON. Owners want caps now for an obvious reason. By structurally limiting costs, they expect to capture the lion's share of future revenue growth. "Everybody figures now's the time to fix wages since we're on the eve of a major expansion of American sports," says NBA Players Chief Charles Grantham. Hockey now has TV exposure and popular new franchises. Basketball is moving aggressively into Canada as part of a broader international outreach. The National Football League's new \$3.64 billion television contract nearly doubled its previous deal. And baseball, when it returns, could rebuild its television fortunes after a dismal 1994.

Payroll predictability is a laudable goal. What employer doesn't want some sort of cost certainty? But it's owners, not players, who offer mega-contracts. When a championship seems within sight, owners will throw economics out the window and break the bank to win. Caps are an effort by owners to create self-discipline artificially. They're asking the wrong people to pay the price of ego run amok.

"It's as if there's an outright conspiracy among the owners in various sports"

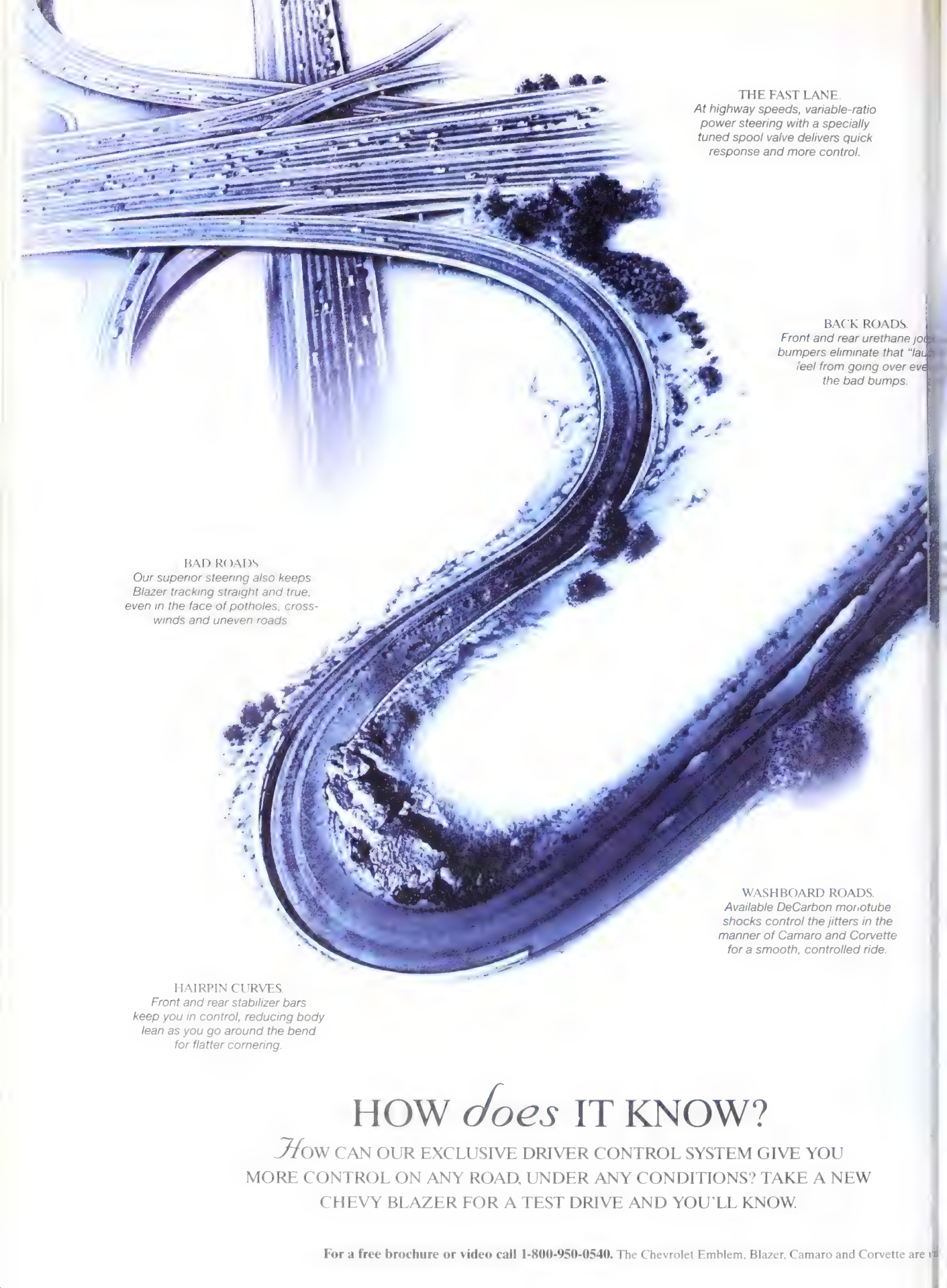
Greising follows sports from Atlanta

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HIGH TECH

BRACING FOR A CHIP DIP

A glut in DRAMs could put a real damper on profits

Is the chip industry's two-year boom running out of steam? On Oct. 3 and Oct. 4, after Advanced Micro Devices Inc. announced that it expects weaker-than-anticipated fourth-quarter earnings, U.S. chip stocks took a battering. Intel Corp. fell 5.7% in the two days, to 58, and AMD dropped 15.5%, to 25%. Micron Technology Inc., already rocked by executive defections, fell 10.5%, to 30%, though it jumped back on Oct. 4. Adding to the jitters: AMD's bad news came just days after influential market watcher G. Dan Hutcheson, president of VLSI Research Inc., shocked the industry by predicting a

5.6% drop in chip sales for 1995 on fears of slowing personal-computer sales.

There is more to worry Wall Street. Price wars already are thinning margins for microprocessor makers such as Intel and AMD. And in the Far East, a growing gang of giant producers of dynamic random-access memory chips, or DRAMs, may be overexpanding production capacity. That could knock 4-megabit DRAM prices from \$11 this summer to \$9.60 by yearend (chart).

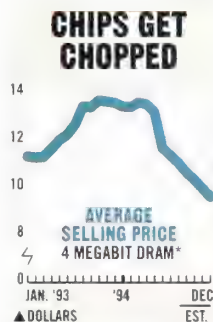
JAPANESE TACTICS. Nobody expects a return to the violent price swings of the 1980s. But a slowdown will be painful, especially for Asian companies that have reaped huge profits from the prolonged global DRAM shortage. Korea's Samsung Electronics and Japan's Toshiba Corp. are both set to double their 16-megabit DRAM production. NEC Corp. also is adding new lines. By 1997,

Korean and Japanese monthly capacity for 16-megabit chips will approach 5 million, more than triple the current amount.

Korea is driving much of the expansion. Its companies seem likely to imitate Japan's old strategy of trading profits for increased market share, dramatically expanding even as prices soften. "We want to be in a position to lead the market," says Ki Young-Ho, DRAM market manager at Samsung. P. Taiwan has just launched a giant government-backed DRAM consortium.

With a little luck, of course, new digital products on the horizon eventually will soak up much of the new capacity. But in the meantime, some of the world's chip companies could be in for a rough ride.

By Larry Holyoke in Tokyo and Robert D. Hofstetter in San Francisco



THE COURT

RULINGS FOR SALE?

The High Court weighs "precedent snuffing"

For four years, Washington (D.C.) entrepreneur Richard Ray Solem tried to hold Century 21 Real Estate Corp. liable for a business venture that went bankrupt after he bought it from Century 21 agents. Solem searched for an earlier court ruling to bolster his fraud suit—one holding the Irvine (Calif.) real estate giant responsible for the actions of its franchisees.

He thought he had hit pay dirt when he turned up a newspaper article describing a 1993 case that held the company liable for race discrimination by its agents. But his hopes were dashed when he learned that, after settling the case for an undisclosed sum, Century 21 and the plaintiff had asked the judge to wipe the opinion off the books.

"DEAD MEAT." Century 21's counsel, Barry A. Zaslav, denies any impropriety. But Solem, who lost his case in June, charges that "if Century 21 hadn't bought off that deci-

sion, they would have been dead meat" since judges rely heavily on prior rulings to decide current cases.

Solem's outrage is spreading. On Oct. 4, the Supreme Court heard arguments about whether judges should be allowed to vacate rulings after parties settle their disputes. Proponents of so-called precedent-snuffing—including the federal government—believe the procedure promotes settlements and helps clear judicial dockets. Opponents say it lets big players rig the law by excising rulings that might hurt them in the future. "It allows wealthy institutional litigants to control the development of

the law by buying and selling judicial opinions," says Arthur H. Bryant, executive director of Trial Lawyers for Public Justice.

The case before the Supreme Court involves Bonner Mall Partnership, which owns a bankrupt shopping center near rural Sandpoint, Idaho, and a creditor, U.S. Bancorp Mortgage Co. U.S. Bancorp wants the justices to order Seattle's U.S. Appeals Court to withdraw its decision regarding Bonner's Chapter 11 reorganization plan, which put the bank behind equity holders in line for payouts. The parties since have settled—but U.S. Bancorp is worried that the ruling might hurt its other cases.

Many lawyers find U.S. Bancorp's request troubling. They complain that insurers too often try to buy off plaintiffs with cash settlements to eliminate adverse rulings. "It's an astonishing manipulation of the system," says Manhattan attorney Eugene Anderson, who represents holders of such insurance.

Supporters maintain that eliminating flawed cases prevents bad law from being made. But clearly, bad law is only part of this debate. The other aspect: fairness vs. efficiency. The Court's prickly task: Deciding which of the two it values more.

By Catherine Yankel in Washington



SOLEM: The decision he relied on was withdrawn



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COMICS

POW! IMAGE IS A KNOCKOUT

This little company puts out 17 best-selling comics

News flash from Kiddieland: There's a new megaforce in town. Action figures based on Spawn, a hugely successful comic book character, recently went into national distribution. And in mid-September, CBS Inc. began airing a new cartoon series based on the WildC. A. T. S comic book superheroes.

That's a major step forward for Image Comics Inc., the unconventional partnership that created Spawn, WildC. A. T. S., and other characters. Formed in 1992 by seven defectors from Marvel Entertainment Group Inc., Image has biffed and baffed rivals ever since. Getting a boost from speculative buying that drove industry sales to an all-time high of about \$900 million last year, Image now has 17 of comicdom's 50 best-selling titles. And through September, it had an estimated 14.5% of the U.S. market, third to DC Comics Inc.'s 19% and Marvel's 33%.

MOVIE DEAL? Image succeeded by coddling its artists. Defying tradition, the privately held company's artist-owners retain all rights to their characters. Other innovations: Each founder has a studio in the city of his choice. Todd McFarlane, 33, Spawn's creator, works out of Phoenix; Jim Lee, 30, another

founder, is based in La Jolla, Calif. A share of the profits from each studio goes to support a headquarters in Anaheim, Calif.

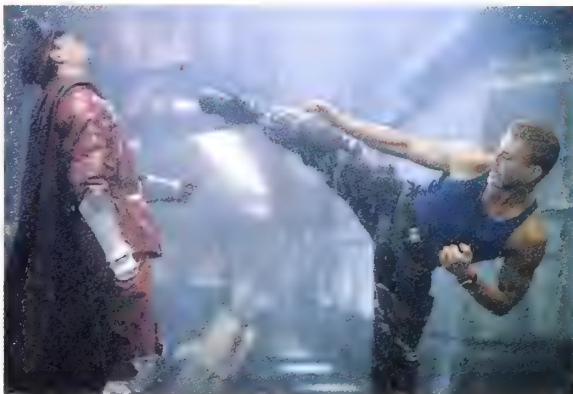
Can such a loose confederation of artists continue to kick sand on bigger rivals? They'll have to weather a comic book slump first.

Merrill Lynch & Co. analyst Lauren R. Fine figures industry sales will fall 10% or more this year. To cope, Image is pushing licensing and looking for a movie deal for Spawn. And analysts figure some of these efforts could hit it big. After all, Image's founders have done pretty well so far for guys with no superpowers.

By Paul Bennett in New York



TODD McFARLANE



BIG SCREEN, LITTLE SCREEN: Universal's *Street Fighter* boasts top-flight special effects—and Val Kilmer as Ryu—to cash in on the video game's cachet



HOLLYWOOD

RAIDERS OF THE VIDEO ARCADE

You've played the game. Now Tinseltown is putting it on film

Hollywood for years has cast a wistful eye on all the quarter-toting teenagers whiling away their weekends in video arcades instead of movie palaces. At first, it tried to co-opt the kids by licensing off blockbuster titles so developers could make Nintendo and Sega games from them. That didn't work out very well. Now, Tinseltown thinks it has a better idea: bring the best-selling arcade games directly to the silver screen.

When Gramercy Pictures releases *Double Dragon* on Nov. 4, it will be the first in a battalion of upcoming movies adapted from computer and video games. *Street Fighter*, from Universal Pictures, will follow just before Christmas, and New Line Cinema Corp.'s *Mortal Kombat*, based on the grisly, phenomenally successful fighting game, is scheduled for release next April. Also on the horizon: movies based on *Doom*, *Myst*, *King's Quest*, and *Leisure Suit Larry*. (The latter documents a quixotic ne'er-do-well in his endless quest to pick up girls.)

ARRIVEDERCI MARIO. Hollywood's aim, of course, is to tap into the \$7 billion that Americans pour into arcade games each year—and the \$6 billion they spend on home versions for Nintendo and Sega game machines. Combined, it's a market nearly 2½ times the size of the \$5 billion movie box office. "These are big opportunities," says Larry Kasanoff, who's producing *Mortal Kombat* for New Line.

Like other knockoffs, moreover,

game-theme movies come complete with a ready-made audience. Japan's Capcom Co. has sold 12 million copies of *Street Fighter* games worldwide and figures that 25 million Americans have played the games at home or in arcades. Given that following, Capcom figures it can at least break even on its \$40 million movie investment. Profits aren't assured, though: After all, Walt Disney Co.'s *Super Mario Bros.*, which was based on the best-selling video game series ever, bombed at the box office last summer.

GORY GORO. So why does Hollywood think it can knock 'em dead this time around? For one thing, the product is hot. Lots of the new flicks are drawing some of the town's biggest names. The movie version of *Doom*, the popular computer game, will be directed for Universal by Ivan Reitman, who did *Ghostbusters* and *Kindergarten Cop*. *Street Fighter* star Belgian martial artist Jean-Claude Van Damme, who now pulls down nearly \$1 million a picture. The movie was written and directed by Steven de Souza, who helped pen the two *Die Hard* movies and *The Flintstones*.

The \$36 million *Mortal Kombat* doesn't have big stars, but Kasanoff signed on Hollywood's priciest technical talent, veterans of such films as *Terminator 2*, *Alien*, and *Cliffhanger*. Special effects include the fearsome, four-armed Shokan Prince Goro, perhaps the most advanced mechanical creature Hollywood has ever made.

The game makers, too, figure that the multimedia marriage will work. "What we gained in the production of the movie is the knowledge and experience that Capcom needs to make video games in the future," says Kenzo Tsujimoto, Capcom's president. Capcom already has transplanted sets and scenes from the movie into its next project. It's due next spring. The title: *Street Fighter II: The Movie Game*.

By Larry Armstrong in Los Angeles

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Duff & Phelps				AAA	AAA	A perfect security rating, been in '91.
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EDITED BY KEITH H. HAMMONDS

A HEALTH-CARE GIANT KEEPS GROWING

YOU'D THINK RICK SCOTT, THE 41-year-old CEO of Columbia/HCA Healthcare, would slack off after engineering three big mergers in little over a year—and, in the process, turning Columbia into the \$10 billion giant of the hospital industry. Yet there he was on Oct. 4, swallowing one more chain—Nashville-based HealthTrust—for stock worth about \$3.6 billion. The purchase adds 116 hospitals, most of them outside urban areas, to Columbia's 195. The move particularly strengthens Columbia's presence in Florida, Texas, and Tennessee. And Scott sees more growth ahead. "We're going

to be full-service providers in every market we're in," he says.

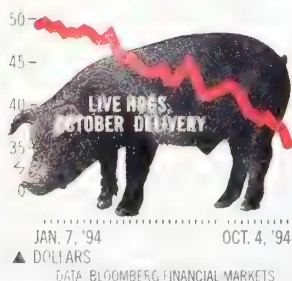
THE PENTAGON'S HIGH-TECH OUTREACH

IN A POST-COLD-WAR WORLD, A downsized U.S. military can no longer support a vast defense industry. That's why, on Oct. 5, the Pentagon announced a new "science and technology strategy." Its centerpiece: the notion that much of the military's technology should come from the commercial sector. The plan singles out key areas for special support. Success in future battles, it says, will depend on a vast array of sensors, communications networks, flat-panel displays, and other technologies that feed data to individual soldiers—and to precision strike weapons.

CLOSING BELL

HOG HEAVEN

A holiday ham soon could cost less than after-dinner coffee: Hog prices have plunged 29% since January, and there's no bottom in sight. The slide started early this year on estimates of an unusually large herd. Farmers kept their pigs from slaughter, hoping prices would firm. But the animals only got porkier, running five pounds heavier than last year, driving prices lower. Bulging supplies of hogs and cattle have boosted profits for such processors as ConAgra, Cargill, and IBP. "It's hog heaven for middlemen," says livestock analyst Thomas Morgan.



THAT'S A LOT OF FRIENDS AND FAMILY

THIS EXPLAINS THOSE CALLS to Abu Dhabi. The Secret Service announced on Oct. 3 that it had arrested an MCI Communications switch technician for masterminding what it says was one of the biggest phone scams in U.S. history. The feds allege that James Lay used a homebrewed computer program to divert and hold calling-card numbers from several carriers that send calls through MCI equipment. Lay couldn't be reached for comment, but the feds say he helped capture 60,000 numbers that were used to rack up more than \$50 million in illegal calls.

THIS DRUGMAKER WANNABE WON'T BE

CARTER-WALLACE HAS ABORTED its diversification from deodorants and condoms into pharmaceuticals. On Oct. 4, the company said it would cut

HEADLINER

A WIDER ORBIT FOR SATURN'S LEFAUVE

After years of bragging about Saturn's success, General Motors on Oct. 4 handed a big promotion to one of its key architects. Richard "Skip" LeFauve, Saturn's president since 1986, will head a new group in charge of GM's domestic small-car operations. LeFauve, 59, will also run Saturn.



Saturn devotees fear the move will curb the upstart division's independence. "It could mean that GM ends up swallowing Saturn," says Michael Bennett, head of Saturn's United Auto Workers local. Not so, says CEO Jack Smith: "Saturn has been extremely suc-

cessful. We don't want to mess with that."

What Smith does want is to boost Saturn's shaky profitability by sharing more components, engineering, and purchasing clout with other GM small cars—a segment where profits are razor thin. LeFauve says Saturn's closer link will help it

draw on GM for technology such as right-hand drive, airbags, and other areas. "We want to take advantage of being part of GM," LeFauve says. His challenge: to do so without jeopardizing what made Saturn a success.

By Katie Kerwin

630 jobs, most of them in drug research and sales, in the wake of regulatory limits on its once-promising epilepsy drug, Felbatol. The drug, used at one point by some 100,000 people, has been linked to six deaths since marketing began last September. Carter-Wallace had counted on Felbatol to boost profits in the face of flat demand for its Trojan condoms and a crowded market for its Arrid deodorant. Now, it will continue to sell Felbatol, but only to patients for whom there are no alternatives. It will manage research on two other drugs—asthma and sepsis treatments—through outside scientists.

A BIT OF LIFT FOR PAN AM'S PENSIONS

THE GOVERNMENT'S LARGEST-ever pension bailout has become a bit less costly. On Oct. 3, the Pension Benefit Guaranty Corp., the federal agen-

cy that insures conventional pension plans, won \$115 million from the estate of bankrupt Pan Am. The funds will cover one-sixth of the \$700 million bailout, with the PBGC's insurance fund picking up the rest. The benefits will go to 37,000 workers and retirees of the airline, which folded its wings in 1991. But some 2,000 pilots and 30 flight engineers won't get pensions because Pan Am promised benefits in excess of the PBGC's insurance limit.

ET CETERA...

- American Express will cut as many as 6,000 jobs from its travel services unit.
- More pain on Wall Street: Goldman Sachs is mulling layoffs of 5% of its staff.
- IBM drafted a new human resources chief, U.S. West executive Thomas Bouchard.
- Reed Elsevier will buy Mead Data Central, owner of Lexis/Nexis, for \$1.5 billion.



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EDITED BY OWEN ULLMANN

THE NEW CIA: SPY—FOR BUSINESS

ce they were likened to the dashing James Bond. Now, America's spies are vilified as bumbling incompetents. Three years after the Soviet Union's demise, the Central Intelligence Agency and its sister spook agencies are under pressure to justify their \$28 billion-a-year budget. While Congress fumes over a string of glaring CIA lapses, the band-dagger crowd thinks salvation lies in beefing up an old backwater: economic intelligence. For now, that new

being overshadowed by juicy scandals—the unmasking of veteran Aldrich H. Ames as a Moscow spy, sex-bias charges by female agents, disclosure of a secret fund to build a \$350 million spy-tec headquarters, and cries for CIA Director James Woolsey's head.

amid all the furor, U.S. intelligence agencies are bent on helping Corporate America in the economic battlefield. Since last year, the once-alloof spy establishment has eagerly rolled out sector-by-sector economic analyses of Russia and other emerging markets for the Commerce Dept. A daily CIA tip sheet tailored to the National Economic Council's priorities keeps the NEC abreast of doings abroad that affect its agenda. For example, during the just-ended trade talks with Japan, the news-tracked Japanese political reform moves of U.S. negotiators. Intelligence agencies "are much more user-friendly than before," says an official. "They're always eager to help us."

NOT WANTED. Despite its fumbles, the CIA is no fool. Sticking on an economic role could preserve the agency's budget. Yet remaking itself won't be enough to spare the agency from cuts in a less-threatening world. What's more, U.S. business doesn't seem to want the help. Executives distrust spy economic analysis, and, notes Glastonbury (Conn.) management consultant Jan P. Herring: "Companies don't want the government to spy for them."

Even so, the CIA can fill a vacuum. White House staff shortages and State Dept. budget cutbacks have forced the Administration to turn to the CIA for statistics and analyses at a time when President Clinton is making international economics a top priority. Just how good the CIA is at reading economic tea leaves is an open question, however. It correctly forecast a slowdown in Russian oil output in the 1970s and a Third World debt crisis in the 1980s. But it vastly overestimated the strength of the Soviet economy.



WOOLSEY: *Under fire*

GLOBAL CHEATS. To bolster its credibility in economic intelligence, the CIA is ferreting out commercial spying and unfair business practices by foreign governments and companies that hurt U.S. business. Last year, the agency says, it uncovered 51 such cases involving competition for contracts worth \$28 billion. Not to be outdone, the National Security Agency, the nation's eavesdropping arm, has produced evidence that Japanese and German companies violated international sanctions against Iraq.

While Administration economic policymakers welcome the assist, there are limits to what the intelligence community can do to advance U.S. competitiveness. For example, there's no support to lift a longstanding ban on stealing foreign trade secrets, even though foreign spook services routinely spy for their countries' commercial advantage.

Despite the legal barriers and lack of business support, a good case can be made for consolidating global economic-intelligence gathering within an independent agency that isn't using the information to make policy. The CIA fits the bill. Besides, clandestine means are often the only way to thwart industrial espionage against U.S. companies. So even if the idea of a nerdy James Bond lacks sex appeal, it might restore some luster to the agency's tarnished image.

By Amy Borrus

CAPITAL WRAPUP

-CHINA

earing television images of himself jousting with China's dictators, President Clinton has decided to rebuff entreaties from Beijing to make an official visit in November after his trip to Indonesia for a summit of the Asia-Pacific Economic Cooperation forum. The White House had hoped that improved relations would make it possible for Clinton to call on Chinese President Jiang Zemin. Indeed, on October 4, China finally agreed to U.S. demands to stop transferring missile

technology to Pakistan. But U.S. officials still believe that a visit would spark a political flap at home because of China's refusal to make progress on human rights. So far, Clinton's only side trip will be to the Philippines.

TAXES

► The next Washington rallying point for high-tech companies will be making the research and development tax credit permanent. With the credit set to expire in June, businesses such as biotech giant Genentech Inc. are gear-

ing up a major lobbying effort. They're counting on strong support from President Clinton because high-tech companies are important to his industrial-policy strategy—not to mention his political fortunes in the key state of California. But there could be a battle looming for the techies next year. Congressional Republicans are vowing to cut taxes if they capture the House this fall, and Clinton may back a middle-class tax cut to revive his sagging Presidency. The industry wants to make sure the R&D tax credit isn't sacrificed.

GERMANY

FINALLY, GERMANY IS PARING THE FAT

Global pressures force industry to get into shape

Reunification sent little CPH Chemie on a scary roller-coaster ride. Like thousands of other German companies, the adhesives maker in the gritty western industrial town of Essen saw its fortunes soar—only to drop sickeningly when the German mark went sky-high. Key markets evaporated, and sales dried up. Two years ago, the \$15 million company looked like a holdover from another era.

Owner Gerwin U. Schüttpeitz decided to fight back. To U.S. business school graduates, his approach might seem obvious, but for a German company, it was close to revolutionary. CPH cut overhead

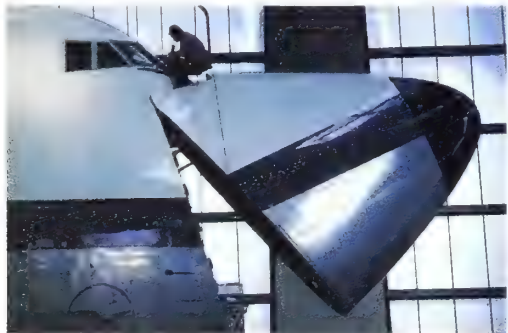
better for 1994, with inflation at 3% and falling. Still, German companies, coming late to an idea that their counterparts in other countries recognized long ago, have finally gotten serious about restructuring the heart of the economy.

Manufacturing productivity is up 10% over 1993. And earnings at Germany's 30 biggest companies are forecast to vault 84% this year. Star performers, such as Munich-based auto maker BMW, are adding extra shifts and hiring new workers. "The change in the past year is dramatic," says Hans-Olaf Henkel, chairman of IBM Europe and soon to be president of the BDI Federation of German Industry, the top business lobby.

Business' mood represents a 180° reversal from the gloom that gripped Germany just a few months ago. Then, the problems of financing eastern Germany seemed insuperable. Half of the East's GDP—more than \$100 billion—came straight from Bonn's coffers. Business bankruptcies ballooned to record levels, and 1 million jobs disappeared in a year—a third of those created in the past decade. Debate raged over whether *Standort Deutschland*, or "Germany as a place to do business," had any future.

But beginning early last year, Chancellor Helmut Kohl used the sense of crisis as a lever to restart a stalled reform program. He lined up state-controlled airline Lufthansa and phone company Deutsche Bundespost Telekom for privatization. This year the government trimmed welfare payments by 3% and made other long-overdue changes, such as allowing private employment agencies to compete with the Federal Employment Office.

Now, the challenge is to keep up the makeover momentum as the good times begin to roll. Already, business leaders are cautioning against euphoria. They worry that although the recently ended recession was deep, it wasn't long enough for companies to make themselves globally competitive. "I don't



A FITTER LUFTHANSA: *Fighting a fare war*

by computerizing the back office, automating whatever it could, and investing in quality improvements. The boss talked employees into working on Saturdays. Costs came down by 20% on key lines. "We had become very fat—and arrogant about our markets," Schüttpeitz recalls. **"DRAMATIC."** That startling admission is being made all across Germany's industrial heartland. From the small and midsize *Mittelstand* companies to such giants as Daimler Benz, industry has shed workers, slashed costs, and moved production abroad. Just five years after the collapse of the Berlin Wall, the self-satisfied bloat that was German industry is looking leaner and meaner.

Of course, Europe's economic recovery has helped. Thanks largely to booming export markets, real growth in gross domestic product is forecast at 2.5% or



know a single company that has finished the restructuring process," says Bern Pischetsrieder, chief executive of BMW. McKinsey & Co. figures the German need years of double-digit productivity growth to catch up. Warns McKinsey German president, Herbert Henzler: "The bulk of the adjustment is still ahead of us."

That's not to detract from the gains already scored. Indeed, Kohl hopes the economic upswing will be enough to carry him to a fourth term in Germany's Oct. 16 federal elections. His Christian Democratic Union (CDU) party has pulled about five percentage points ahead of

GERMANY

Recovery has slowed the steady climb of unemployment, but more layoffs lie ahead. Unless productivity keeps improving, competitiveness will fall behind again.

DATA: FEDERAL STATISTICS OFFICE, COMMERZBANK



STUMP: If Kohl's party falls short of a clear mandate, reform could stall

opposition Social Democratic Party in the polls.

Kohl can maintain his grip on power. Optimists are even expecting a repeat of the "economic miracle" that made Germany an industrial juggernaut in the 1950s and 1960s. Radical restructuring has become possible now because the 40-year-old social contract between industry, government, and labor in Germany is developing cracks. Reunification has forced business to challenge practices carved in stone. In eastern Germa-

ny, companies have refused to join employers' federations that negotiate with unions. That way, they escape binding national labor agreements covering whole industries and can concentrate on individual company bargaining. In the West, IBM Deutschland effectively took all non-production workers out of the IG Metall contract for the same reason. And now hundreds of *Mittelstand* companies are doing the same.

Some of what's happening, says Walter Riester, deputy leader of IG Metall, "goes to the heart of the social consensus and

German industry is not globally competitive yet: "The bulk of the adjustment is still ahead of us," warns the head of McKinsey's German unit

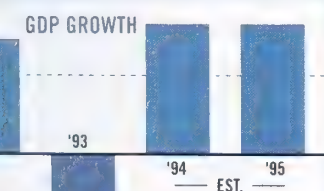
labor relations in Germany." Watching the bottom line, companies no longer act with their former knee-jerk generosity. Digital Equipment Corp.'s German subsidiary changed its mind about offering \$103,000 apiece to laid-off employees, deciding such payments would have been too costly. Fearing even steeper job losses, workers have become more flexible. The chemical workers' union, IG Chemie, has made an unprecedented concession by agreeing that employers could hire young workers and long-term unemployed at 90% of union scale.

EXPORTING JOBS. Widespread pay restraint helped cut unit labor costs in industry by 6% last year and may have opened a negotiating wedge for employers. Ultimately, a quarter of BMW employees' salaries could become variable. Employers are urging two to three years' more moderation at least, lest cost pressures force even faster layoffs despite the recovery.

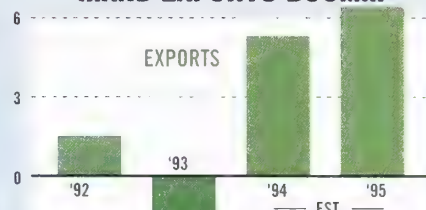
The stick prodding workers to change is the same one propelling management: global competition. "The German worker is now directly competing with the Russian, Polish, Chinese, or Malaysian worker," says Meinhard Miegel, head of the Bonn-based Institute for Economics & Society.

Industry is increasingly moving production of low-profit items with heavy labor content out of Germany while keeping high-tech products at home. Han-

THE ECONOMY REVIVES...



...AND EXPORTS BOOM...



...JOBLESS RATES LEVEL OFF



over-based tiremaker Continental bought control of a Czech tiremaker and moved production of standard tires there. Auto parts maker Bosch has shifted headlight production to Malaysia, while Daimler's AEG unit has casings for giant electrical transformers made in Turkey. Luxury carmakers BMW and Mercedes-Benz are both building plants in the U.S., where potential efficiency gains are enormous. An example: BMW's Spartanburg (S.C.) plant, just started up, will turn out 100,000 cars a year with 2,000 workers. Back home in Regensburg, it takes 6,000 people to make 150,000 units.

In some industries, such as textiles and apparel, jobs are being exported on a massive scale. In the past five years, more than a third of garment production has left Germany. "It's not impor-

many such changes will require tough-minded legislation. Kohl has made some progress. Since the government bit the bullet over selling off Lufthansa, for instance, the airline has slimmed down, returned to profits, and launched a ferocious fare war with interlopers such as British Airways PLC.

But many observers fear the elections will produce a "Grand Coalition," a cumbersome CDU/SPD alliance in the Bundestag. The danger is that much needed reforms of everything from the tax system to social security could be put on hold as the unwieldy coalition labors to work out a government program. The two parties have widely different approaches. For example, while the Socialists think that government, labor, and companies need to hammer out a job-creation program,

covering everything from shopping hours to building permits and biotech research, protects the status quo. Concludes McKinsey's Henzler: "We don't have the Bill Gateses of this world's role models in this country."

SOFTWARE GIANTS. But that is starting to change. Take Rolf Geisen, co-manager director of Aachen-based Parsytec, an eight-year-old supercomputer start-up. Geisen helped organize a Sept. 30 congress of 50 high-tech companies in Aachen to inspire others to stop griping and catch the entrepreneurial spirit. "We can only change the world if we each start doing something ourselves," he says.

Both the U.S. and Japan lead Germany in patent filings, a rough gauge of inventiveness. But it already has two software giants, SAP and Software



SIEMENS' STRIDES: It's regaining ground in chip technology and expanding abroad

tant where you produce," says Konrad Jud, chief executive of Ingolstadt-based Bäumler, a clothing maker that does 30% of its production in Hungary. "The price is important."

UNWIELDY COALITION. Asia is also a huge magnet. Chemicals company Bayer is investing \$200 million in half a dozen ventures in China, including plants to make film and engineering plastics. Similarly, electronics giant Siemens this summer earmarked more than \$500 million for 15 Chinese joint ventures, from power plants to personal-computer assembly. Meanwhile, Volkswagen, already a major auto producer in China, is considering a move into India.

Besides cutting labor costs, German business still needs to push for regulatory changes—allowing more flexible working hours, for instance, and more freedom to offer discounts. Trouble is,

Kohl and his allies are promising to extract government from the economy—slimming down the state just as the private sector has begun its diet.

Arguably, Germany's wide social-welfare net, covering everything from child allowances to health care and retirement pensions, should be the next candidate for downsizing. It swallows a staggering one-third of the national income. When items such as vacation pay and supplementary pensions are factored in, fringe benefits cost nearly as much as gross wages. Total costs per worker per hour are estimated at \$25, compared with \$16.50 in Japan and \$15.50 in the U.S.

Business, too, needs a continued shakeup. For many, the comfortable days of old have created a deep aversion to risk-taking. Venture capital barely exists. A forest of petty regulations,

Germany's lavish social-welfare system may be the next patient to go on a diet: Workers' benefits often nearly equal wages

among the world's top 10 in the business, the only non-Americans on the list. And once lumbering giants such as Siemens have made huge strides clawing back lost ground in semiconductors.

Germany does have the ingredients for a world-class, competitive economy: a highly educated workforce, impressive scientific centers, big research and development budgets, and strong culture of export-driven *Mittelstand* companies. Now, led by its corporate heavyweights, Germany Inc. is evolving into the hub of an increasing multinational enterprise, spanning Eastern and Western Europe and beyond.

If it is to succeed worldwide, however, the country needs to shrug off its protective armor—from pettifoggish regulations to the too comfortable social-welfare system. And although recession blew away the arrogance and reduced some of the fat, companies will have to remind themselves continually that efficiency is a way of life, not a quick fix.

By John Templeman in Bonn, with Gail Edmondson in Paris and Karen Lowry Miller in Hanover

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BRITAIN

MURDOCH LAUGHS LAST—AGAIN

His BSkyB satellite TV outfit healed so well it may go public

In late 1990, Rupert Murdoch merged his floundering British satellite TV service with a debt-plagued competitor. Saddled with \$2.7 billion in debt, the new British Sky Broadcasting Group proceeded to lose \$4.5 million a week for the next six months. Even after Murdoch and three other owners pumped in \$1 billion to keep the venture afloat, most analysts predicted the company's demise within a year.

Fast-forward to late summer, 1994: BSkyB reports a \$280 million operating profit for its fiscal year ended June 30 (chart). Now, its four major owners are looking for ways to cash in. Barring last-minute complications, they've all but decided to issue new shares for a public offering in London and New York later this year. The flotation of a 20% stake could value BSkyB at an eye-popping \$7 billion.

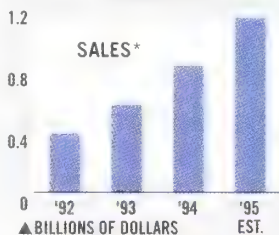
HOT MARKET. The sale will provide a major cash boost to Murdoch, whose News Corp. holds a 50% stake. Murdoch could walk away with \$800 million and still control the company with a 40% stake. One adviser to Murdoch says the media baron will use the funds—and BSkyB as a model—to turn around the struggling Star TV satellite network in Asia. Murdoch paid \$525 million last year to buy 64% of the Hong Kong-based network.

An additional \$800 million in proceeds would be shared by British media conglomerate Pearson PLC and French media-and-textiles company Chargeurs, each with 17.5%, as well as British media company Granada Group PLC, with 13.5%. One possible stumbling block: reaching agreement on how much Chargeurs will pay the other owners for special drawing rights to keep the French company's holding at 17.5%.



OFFSIDE? Murdoch's media are so ubiquitous they're a political issue

AS BSkyB SALES PICK UP SPEED...



...ITS EARNINGS GO INTO ORBIT



*Fiscal years ended June 30

DATA: COMPANY REPORTS, BZW SECURITIES LTD

That BSkyB's owners are bickering over the spoils shows just how far the TV satellite service has come since 1991. BSkyB's management team, led by Chief Executive Sam Chisholm, a protégé of Murdoch, ruthlessly slashed costs, reduced staff, and used a variety of marketing ploys to pump up sales of satellite dishes. More than anything, however, BSkyB is testament to the red-hot state of Europe's media markets and the economics of satellite TV.

FREE STATIC. The watershed came a year ago, when BSkyB had a critical mass of 3 million

viewers. It encrypted the signals broadcast from the Astra satellite, and many viewers had to start paying for the service for the first time. A second price increase took effect on Oct. 1. Subscribers now pay an average of \$25 a month for a basic service plus a premium chan-

nel, and many pay up to \$40 a month for all 10 channels. "There will be a point when we'll meet price resistance," says BSkyB Chief Financial Officer Richard Brooke, "but I don't think we've found it yet."

BSkyB pulled off a series of programming coup as well, including paying \$400 million for exclusive rights for five years to certain British soccer games. It negotiated long-term contracts for exclusive rights to films produced by the major Hollywood studios, including Murdoch-owned Twentieth Century Fox Film Corp. And it cut deals with other programming suppliers, such as Viacom International Inc. and Tele-Communications Inc., the largest cable-TV operator in the U.S. Sources say TCI is so impressed with BSkyB's progress that it, too, has been in talks to take a stake.

BSkyB, in fact, may be too successful. British politicians and rival media barons worry that Murdoch soon will control the bulk of programming, dominate the satellite space, and control access to far more viewers than those who subscribe to his own service. Such gatekeeping could be done by his subscription-management services.

DATED TECHNOLOGY. But BSkyB does have some problems. It is still using analog signals as a new era of interactive services using digital technology about to begin. "They have the wrong technology to be a long-term player," says Michael Grade, chief executive of Channel Four, one of Britain's two independent channels.

That's why BSkyB, with 16% of the British market, is experimenting with digital signals. It's also testing a movie service with British Telecommunications PLC that uses voice phone lines. Its new sports channels are already seen throughout Europe on other systems and there are plans to make them available globally. BSkyB has proven to naysayers wrong once before, but this time, lots of spare cash might make the job a bit easier.

By Paula Dwyer in London, with Pete Engardio in Hong Kong



Companies with a Mita DC-8585 high-speed copier become productive.



Those without become fossils.



HOT CACHE: Arms seized from Mexican drug dealers

MEXICO

FIGHTING REFORM—WITH BULLETS

Zedillo's promised political changes face murderous opposition

He doesn't take office until Dec. 1, but Mexican President-elect Ernesto Zedillo Ponce de León already has a crisis on his hands. His challenge is to come to grips with a mounting sense of lawlessness in Mexico. In particular, he has to respond to revelations that a congressman from his own Institutional Revolutionary Party (PRI) organized the Sept. 28 assassination of the party's secretary general and had a hit list of other enemies. The dirty implication: The old guard of the PRI, which the Attorney General's office alleges may be allied with drug dealers, is trying to block political reform.

The Attorney General's office says that federal congressman Manuel Muñoz Rocha, who represents the state of Tamaulipas along the Mexico-U.S. border, ordered the killing of PRI Secretary General José Francisco Ruiz Massieu. Muñoz has admitted involvement in the conspiracy. The Attorney General's office says at least nine people have been implicated.

NEW URGENCY. The motives could include vengeance from political rivals and from drug traffickers who wanted to intimidate Ruiz' brother. Mario, the assistant attorney general in charge of

Mexico's antinarcotics fight. But one of the implicated men told the Attorney General that Muñoz wanted to kill Ruiz to prevent him from becoming leader of the Chamber of Deputies and implementing political and administrative reforms that party hard-liners oppose.

As a result, Zedillo's campaign promise to carry out sweeping reforms in Mexico's flawed law enforcement and justice systems has suddenly taken on new urgency. The stiffest part of the challenge may be weeding out corrupt members of his own party. And while foreign investors have taken Mexico's volatility in stride, some say the uncertainty is starting to exact a toll on the country's image as an inviting place to invest and work. The Mexican *bolsa* has dropped 5.5% since Ruiz' killing.

Zedillo's transition team is hastily

drafting legislation that plans to introduce as soon as he begins his six-year term. Among the proposals are better salaries and training to professionalize Mexico's notoriously corrupt cops, some of whom are believed to be involved in kidnappings and drug rings. Zedillo also hopes to create a judiciary that is more independent of his party and more able to resist drug money. To combat an alarming wave of kidnappings—more than 800 were reported over the past year—policymakers want to make it a federal crime and create a special antikidnapping unit.

UNDER THE RUG. There is no guarantee that such reforms will work, but they are part of the process of making Mexicans believe in their justice system again. More than six months after a gunman killed PRI presidential candidate Luis Donaldo Colosio at a campaign rally in Tijuana, investigators have failed to ferret out all those believed responsible for the crime. One of the trigger men, Mario Aburto Martínez, is in jail facing a 50-year sentence, having pled guilty to the crime.

It would be bad enough if politicians were the only ones being targeted. But in the past six months, two prominent businessmen were kidnapped and forced to pay enormous ransoms, one of at least \$30 million. The crime wave has led to a boom in armored car sales. Mark F. Burton, president of International Armoring Corp. in Ogden, Utah, says he has expanded his workforce from 6 to 82 in just 18 months to deal with the growing Mexican demand for armored cars. He has sold nearly 20 such cars, costing around \$100,000 apiece, to Mexicans in that period.

Given these conditions, analysts say that no matter how sincerely Zedillo intends to open up Mexico's political system, such reforms will be meaningless. Mexicans cannot believe in the rule of law. "The justice system is completely discredited," says Santiago Creel Miranda, a prominent lawyer who has been serving as one of the six citizen overseers of the Federal Election Institute. "This country is a festival of impunity, where no one is held responsible for anything." That's far from an auspicious start for a new President.

By Geri Smith in Mexico City

A congressman from the PRI admits taking part in the plot against his secretary general



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ED BY JOHN PEARSON

ITALY: WHY BIG BUSINESS BACKING BERLUSCONI AGAIN

These are boom times for Bologna-based G. D. The family-owned manufacturer of cigarette and candy packaging machines racked up \$400 million in sales last year to national giants like Philip Morris, Unilever, and Nestlé. The company's profit stream is now rich enough to bankroll production units in South America and Asia, adding to its presence in the U.S., Germany, and Britain.

G.D. is not alone. After three of the most difficult years since World War II, Italian industry is now working overtime. Thanks to booming exports, the Italian economy should grow next year by nearly 3%, almost double this year's anemic performance. "The government is working in the right direction," says G.D. Managing Director Giancarlo De Martis. "I'm waiting to see whether Berlusconi can keep his balance."

CONPARING. Six months after being named Italy's leader, the tycoon turned politician is finally taking some action. In his first budget presented to Parliament on Oct. 4, Prime Minister Silvio Berlusconi threw down the gauntlet to the country's once powerful unions. At the same time, he announced plans to slash \$30 billion from the 1995 budget deficit is a move to tame the country's ultrarich pension system.

Key to getting Italy's astronomical budget deficit down to less than 10% of gross domestic product, Berlusconi stands a pretty good chance of getting his plans passed in Parliament. And although Italy's three main trade confederations have ordered a general strike on Oct. 14 in protest, opinion polls show that the public backs Berlusconi's promise to bring reality to public finances. "Not even 10 years of strikes will make two plus two equal anything other than four," says the newly combative Prime Minister. Thanks to that attitude, big business in northern Italy is lending its weight behind Berlusconi. Although elected on

a probusiness platform, Berlusconi quickly lost the support of influential industrial clans such as the Agnellis when it looked as if the former media mogul was unable to restrain extremist and populist elements in his coalition. Now, that could be changing. At a small dinner for Berlusconi hosted by Fiat Chairman Gianni Agnelli in late September, Italian industrialists had a message for the Prime Minister: Stay the course, and you have our support.

EXPORT BOOM. The dinner guests chez Agnelli, such as Olivetti Chairman Carlo De Benedetti and Pirelli chief Marco Tronchetti Provera, want to make sure the good times stay. A

weak lira, coupled with corporate tax breaks rolled out by Berlusconi last summer, is igniting exports and investments. Although domestic demand is still weak, sales of Italian goods to the U.S. market this year are up almost 25%. Bottom lines are already showing the effect: Fiat, Italy's biggest private company, turned in almost \$500 million in profits in the first half of this year.

Berlusconi could still be tripped up by dissension within his uneasy coalition of right-wing nationalists and the populist Lega Nord. And government officials are worried that anticorruption

investigators may soon turn their attention to Berlusconi himself. Several companies within his \$7 billion Fininvest media empire have already come under the spotlight. Berlusconi could now be particularly vulnerable for allegedly hiding a controlling stake in Telepiù, Italy's largest pay-TV network.

But if he emerges unscathed from the probes, Berlusconi probably has a good chance to remain in office much longer than the average 13-month life span of postwar Italian governments. A big reason is that he is now getting the best kind of support any government could want: an improving economy.

By John Rossant in Rome



BERLUSCONI: Getting tough with unions

GLOBAL WRAPUP

OPENINGS TO ISRAEL

Companies will take a fresh look at investment prospects in Israel following the Sept. 30 decision by the six-nation Gulf Cooperation Council to end blacklisting of companies that do business with Israel. Construction giants are likely to be drawn to projects such as multibillion-dollar Israeli-Jordanian water schemes. "The big construction firms working in the Gulf have been edged out of the Israeli market," says Aviv consultant Danny Halperin. "It is likely to change." More oil is

likely to flow, too, through the Eilat-Ashkelon oil pipeline, which links the Gulf of Aqaba and the Mediterranean.

The Persian Gulf states still won't trade directly with Israel—formally, at least. But this ban is eroding, too. Israel's Energy Ministry is dickering to buy gas from Qatar, a deal in which Houston-based Enron could play a role, and, separately, from Egypt, with Amoco and Italy's Agip as participants.

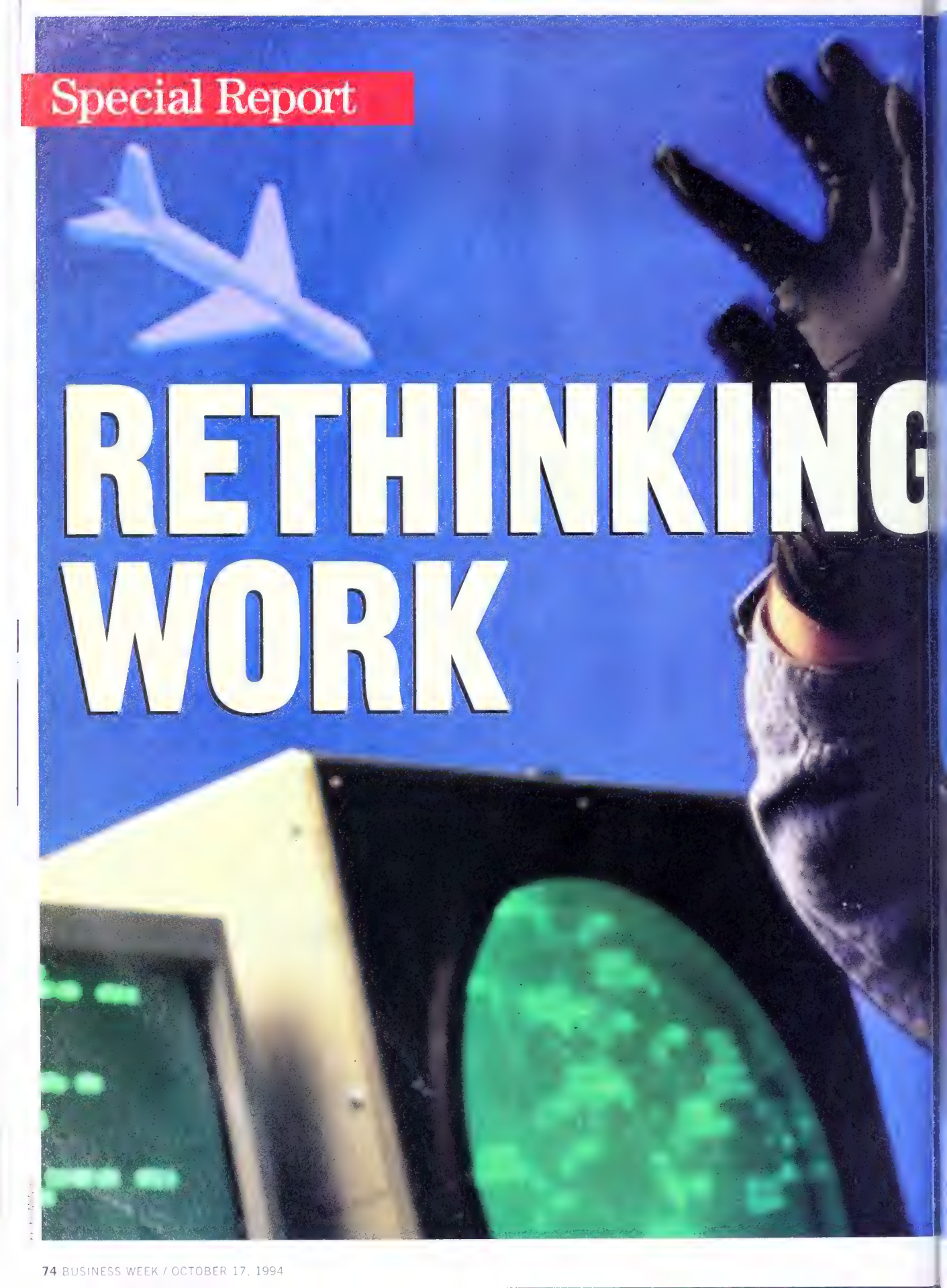
JAPANESE COMEBACK

► Fallen political strongman Ichiro Ozawa is attempting to create a new

political party. The "shadow shogun" behind the governments of Morihiro Hosokawa and Tsutomu Hata, Ozawa lost his power in June when Hata's coalition was defeated by a combination of the Liberal Democratic Party, which ruled Japan for decades, and the Japan Socialist Party.

Now, all opposition groups with the exception of the Communists are trying to create a grand new party, with Ozawa in charge. If he succeeds, the new party will be almost as big as the Liberal Democrats and will challenge the ruling coalition.

Special Report



RETHINKING WORK



The economy is
changing. Jobs
are changing.
The workforce is
changing. Is
America ready?

TABLE OF CONTENTS

THE NEW WORLD OF WORK

Empowerment and mobility for some, fear and frustration for others. *page 76*

ODE TO THE WATER COOLER

In the age of the virtual corporation, is the colleague a thing of the past? *page 86*

THE RISK ECONOMY

A new willingness to roll the dice shows up in productivity, profits, and wages. *page 88*

A WIND BLOWING ROUND THE WORLD

Change is happening in every workplace, but some countries will be left behind. *page 92*

IT'S NOT EASY OUT THERE

How seven workers are navigating their way through the new labor environment. *page 94*

A PHOTOGRAPHIC HISTORY

The faces of toil are vastly different today than they were 65 years ago. *page 106*

THE FUTURE OF AIR-
TRAFFIC CONTROL?
LOOKING AHEAD AT A
U OF WASHINGTON LAB

THE NEW WORLD OF WORK

Beyond the buzzwords is a radical redefinition of labor

It's 9 a.m., and the workplace of the future is... awfully quiet. On one side of the converted warehouse, beneath orange girders and massive yellow ducts, perhaps 50 of 220 desks are occupied. Employees tap at laptop computers, or whisper into phones; some meet in small groups or venture across "Main Street" to confer with administrators and managers. A low roar from the air conditioning blankets the cavernous space in antiseptic stillness.

Beneath the remarkable austerity at IBM's new Cranford (N.J.) sales office, though, is something of a revolution. The 600 representatives based here have no offices; a day each week, or less, they come in to pick up mail and see associates, and are computer-assigned a spot with little accoutrement save one chair, a telephone, and a jack for a laptop.

Most of the time, they're on the road. Software marketer Lynn M. Fox gets most administrative work done by modem, from home or spare offices at customer sites. Her time with customers is better spent: Because all the product, pricing, and technical data she needs are available via her laptop, a bid takes minutes, not days, to work up. No approvals are needed from the office bureaucracy. She's home by 6 p.m., allowing her a few hours with Matthew, her three-year-old, before she checks in again for electronic messages. It's still a 10-to-12-hour workday, "but a lot more productive, and I have more control," she says.

Duke Mitchell directs all this from a steel desk, just like the others, at one windowless corner of the room. His lieutenants, who work in similar spaces, are few: In moving five sales offices to Cranford, Mitchell cut out two layers of middle management. He also halved the number of sales and service reps. Paneled offices? Gone. Fancy art? No more. Except for the carpeting, all the furnishings are used. "This isn't about importance, about epaulets," says Mitchell. "It's about what you get done."

My dad worked here for 38 years. He retired here. Now, if the company can make a product cheaper, or serve the customer better, it's going to leave. You can't blame them. Everyone has to work for themselves. Individuals have to be as flexible as companies are in the '90s. —Kevin Whalen, 33, laid off when Procter & Gamble Co. shut its Quincy (Mass.) factory.



Mobility. Empowerment. Teams. Cross-training. Virtual offices. Telecommuting. Reengineering. Restructuring. Delaying. Outsourcing. Contingency. If the buzzwords don't sound familiar, they should: They are changing your life. The last decade, perhaps more than any other time since the advent of mass production, has witnessed a profound redefinition of the way we work.

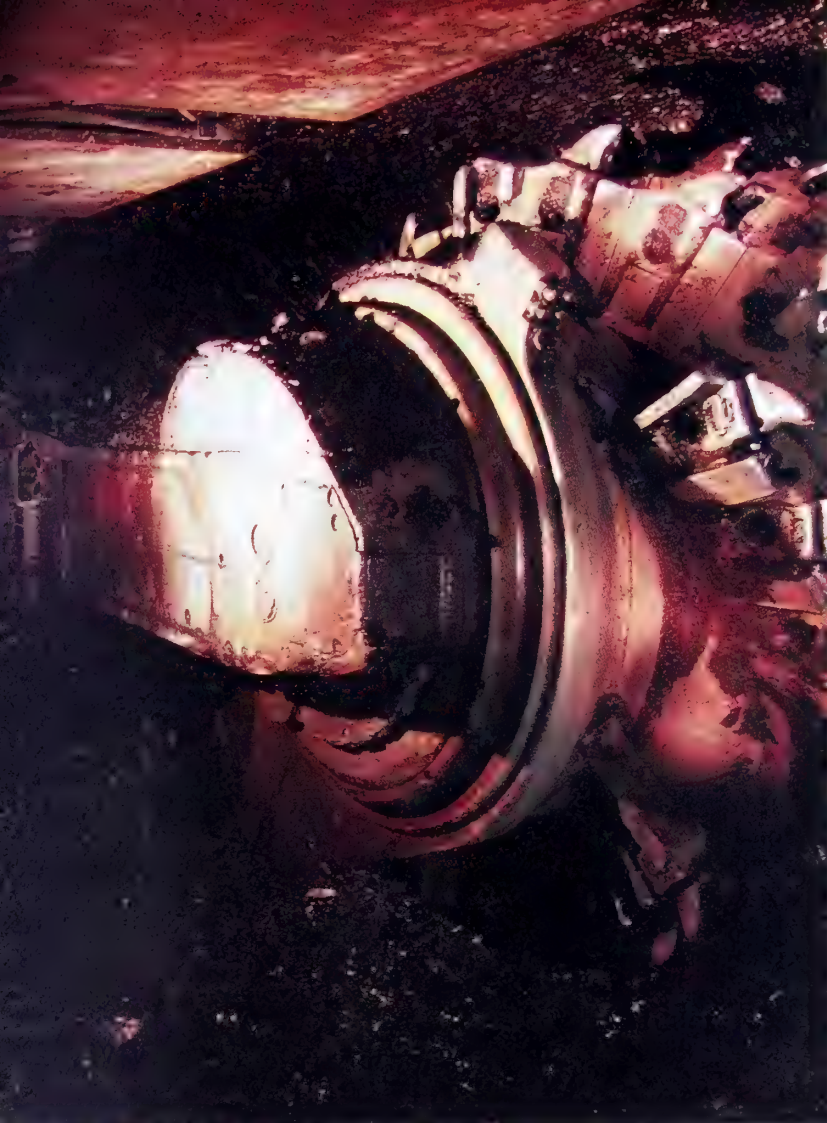
The job, certainly, is not dead. There's still a robust need for relationships between employer and employee that rely on stability, security, and shared economic interests. "Man has always sought the company of people, and that will continue to be the driving force of organization," says CEO Robert J. Saldich of Raychem Corp., one employer that is creatively confronting workplace changes.

The relationship isn't what it was. The new compact between company and worker dismisses paternalism and embraces self-reliance. Bid farewell to unconditional lifetime employment, even at the bluest of blue-chip companies that once implicitly turned on such an ethic. "That

MOBILITY

The new compact between company and worker embraces self-reliance

A chair, a phone, and a laptop. IBM's austere new office in Cranford N.J.



LABOR EFFICIENCY

Better technology, better processes, and fewer, better-educated workers

Workers at the Twentymile Mine shear coal from the wall using remote controls

clearly is no longer the name of the game," says Kevin Becraft, director of employee relations and resources at IBM, which has cut 171,000 jobs since 1986. "Instead, it's lifelong employability." The key difference: shared responsibility. Employers have an obligation to provide opportunity for self-improvement; employees have to take charge of their own careers.

If your company hasn't laid that out, you could probably guess. More than likely, you are working longer and harder, and making less money than did someone in comparable work a decade ago. Constantly in training, you must acquire new skills to keep up with new technologies. The corporate terrain is shaky, with near-continuous downsizing and reorganization reminders that anything can change; shared, too, is the risk of business itself.

A global economy, rousting American employers from business-as-usual management, demands such change; rapidly evolving technology allows it. "Almost

every employment relationship is contingent on the employer being able to continue in the same business with the same product and the same technology with the same quiescent competition," says Audrey Freedman, a former Labor Dept. economist. "Now, who's in that position?"

ELEGANT RESULT. Essentially, no one is: We confront a workplace that will evolve year after year. Many will find the result both enervating and rewarding. In companies that are flattening hierarchies and, bit by bit, decentralizing decision-making, workers are gaining greater control over what they do; self-direction has superseded the doctrine that workers do only what they're told. High performers are rewarded with higher pay. And flexible human resource strategies can free workers to pursue more fulfilling combinations of varied work, family life, and other interests.

The resulting business can be as elegant as European Collision Center, a tiny auto body shop in Cambridge, Mass. There, worker empowerment and autonomy drive customer service. Bodymen take "ownership" of a car while it's in the shop, staying with it start to finish. No one looks over their shoulders: "There are a set of parameters, then they have to be responsible," says owner Wayne Stevenson. Workers are cross-trained to take on new tasks and sent back to school yearly to keep skills up to date. Customers love what they get, and Stevenson's traffic has doubled every year for five years.

The question: How many losers will there be? Not everyone, certainly, will be empowered. For many workers, part-

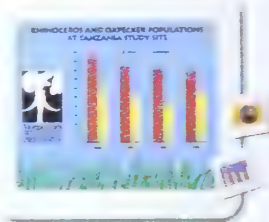
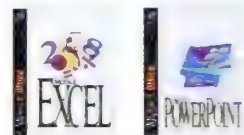


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time jobs and temping will mean less money, not more freedom. Low-skill employees will be marginalized in a labor market that rewards education and training. In companies that cut jobs without redesigning processes and structures, the remaining employees simply will take on more work.

Here's one clue to the future: The Bureau of Labor Statistics' occupational forecast for the year 2005 (chart). Notice which jobs are gaining: professional, managerial, and technical—high wages, high skills. What's losing: crafts and operators and laborers, the domain of low-skill union jobs. Then there's that jolting bar to the right: Service workers—that low-pay catch-all for everyone from burger-flippers to home health aides—will gain 6.4 million jobs.

Any forecast for a decade down the road is open to question, of course. Statistical noise, though, shouldn't obscure the essential challenge: Everywhere, workers and their employers will have to rethink traditional roles and relationships. Even as both sides warily look each other up and down, they'll be confronted with the need to act fast, to transform new competitive pressures into mutual gains.

Years ago, we had one guy who told us what to do and we did it. He made all the decisions. We never really had any input. Now, you have to listen to your men. They have empowered us so much that we don't have to do a job if we think it's unsafe. If I tell one of the men to do a job and he thinks it's unsafe, we sit down and talk about it. —Joseph Stiffarm, Burlington Northern Inc. track foreman, Havre, Mont.

Plant 12, Pulaski Furniture Corp.'s new \$20 million factory in Pulaski, Va., is a gleaming testament to technology's capacity for reordering work. Computerized equipment shapes wood with spurts of laser beams; an automated machine instantane-

ously cuts eight pieces. Each would take a craftsman 30 minutes by hand.

Special Report

This is labor-eliminating automation at its most severe: Plant 12's 125 workers manufacture more furniture than five times as many people at Pulaski's much larger Dublin (Va.) operation. The technology lowers costs, keeping Pulaski ahead of competitors. It also leaves 60-year-old Howard Frazier strangely out of place. Having fashioned furniture by hand for 40 years, he now advises a new breed of machine operators, 90% of them computer-literate. "They have good educations and they know about computers, but they don't know a lot about building furniture," Frazier says.

Technology's starkest feature is its inexorability: Today,



**INFORMATION
POWER**
Decisions can
be made faster,
by those closest
to the customer

*7-Eleven manager Price:
"Before this, we had no say
about what we needed"*

the power of a personal-computer microchip doubles every 18 months. Our ability, as a nation, to maintain and build wealth depends in large part on the speed and effectiveness with which we invent and adopt machines that lift productivity.

Such a relationship has been a given throughout the Industrial Age, as has the job loss that automation normally produces. In the last decade, though, technology and concomitant restructuring have had a disconcerting effect on the U.S. workforce, dramatically widening the divide between those with more skills and those with fewer. Although pay, adjusted for inflation, has dropped across the board, it has fallen far more for those without college degrees (chart).

It's no cyclical oddity. "We are in the midst of a major polarization of work," says consultant Michael Hammer, America's high priest of reengineering. "Organizations need fewer and fewer of better and better people. The jobs organizations are going to have are going to be better jobs."

Visit Cyprus Amax Mineral Co.'s Twentymile Mine near Oak Creek, Colo., where workers with push-button controls walk alongside massive machines that shear 30-inch slices from an 850-foot coal wall. Laptop computers help miners track equipment breakdowns and water quality. "Down on the

PERCENT
CHANGE IN
SHARE OF
TOTAL
EMPLOYMENT,
1992-2005

OCCUPATION ▶

EARNINGS* ▶

**PROMISE AND PERIL IN A
POLARIZED JOB MARKET**

High-wage occupations will grow, creating more opportunities for those with skills and education. But low-paying service jobs will also be on the rise.



EMPOWERMENT

Team-based systems give workers more satisfaction

At European Collision Center, bodymen work on a car from start to finish

longwall, you don't feel any less of a man when the day is over," says Charles J. Kistler, 38, who walks six miles on a good day, carrying 25 pounds of gear. But these aren't the illiterate laborers of mining's past. The average Twentymile employee has two years of college; an executive says the company looks for people with "high math skills, more technical background, more comfort with electronics."

Better technology, better processes, and fewer, better workers. The ideal: Technology that actually helps workers make decisions, in organizations that encourage them to do so. That's the promise of computers, just now starting to be realized. "Free access to information across an organiza-

tion eliminates the need for hierarchical management systems that existed before," says James K. Sims, CEO of consultant Cambridge Technology Partners Inc. People can think for themselves. Decisions can be made faster, by those closest to the customer.

Such is the intent of Southland Corp. as it expands the autonomy of its 7-Eleven store managers. In a Texas pilot project, managers track daily orders and leftovers of fresh sandwiches and pastries on handheld computers; a headquarters computer processes the data and generates a report on sales and profits the next morning.

Bob Price, a store manager in The Colony, Tex., a Dallas suburb, makes use of such data to map out future orders, figuring in weather reports, special events in the area, and other factors that could affect demand. He decides what and how much to order. "Before this, we had no say about what we needed in our store," Price says. "Either you had a field consultant come in and say we need to have more of something, or else they'd just automatically ship stuff. Now, we have to make decisions."

Empowerment, of course, is a fixture on manufacturing floors, pioneered in the U.S. by carmakers and the United Auto Workers. Now, a decade or so behind, service indus-

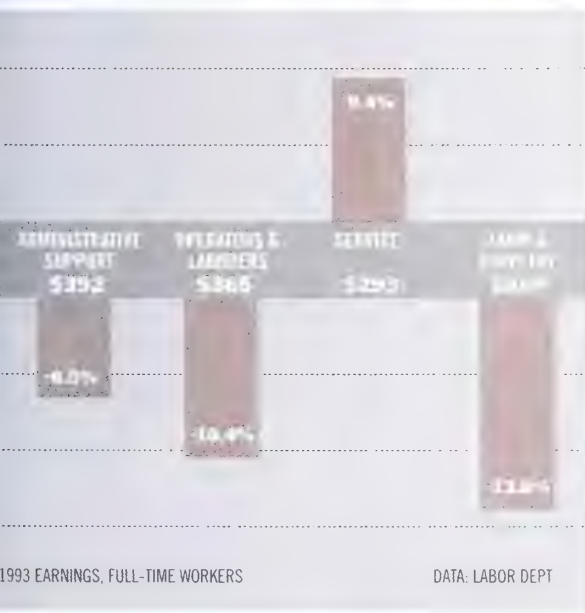
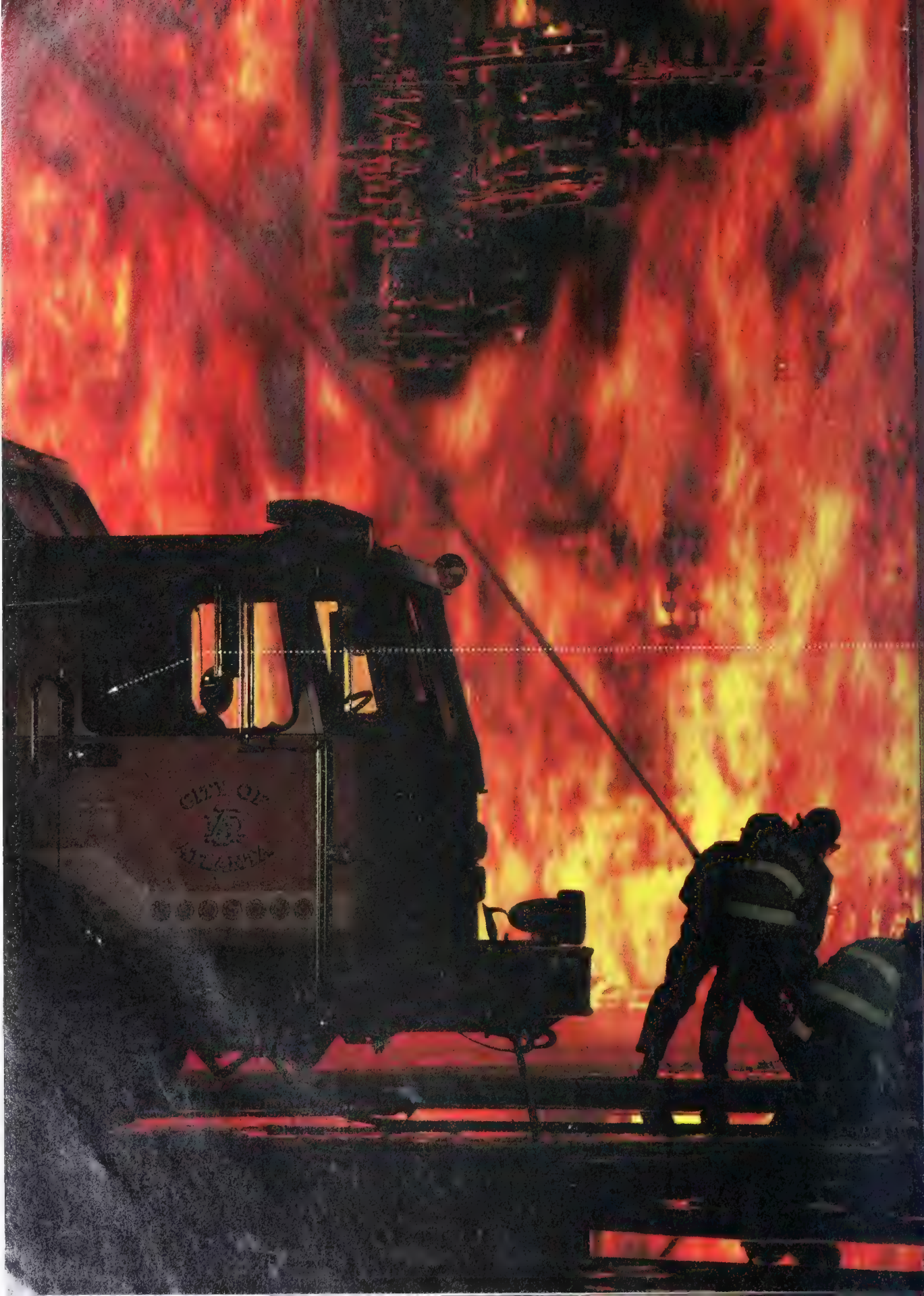


PHOTO BY DAN BEVANI, CHART BY USA KROUSE BEAMAN NEW



THE CITIZENS OF ATLANTA, GEORGIA, DEPEND ON THEIR FIRE DEPARTMENT. THE ATLANTA FIRE DEPARTMENT DEPENDS ON A MURATEC PLAIN-PAPER FAX MACHINE WITH SUPERFINE RESOLUTION AND ERROR CORRECTION. IT'S USED TO RECEIVE DRAWINGS OF BURNING BUILDINGS AND SAFETY DATA SHEETS ON HAZARDOUS MATERIALS. MURATEC COUNT ON IT.



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tries are discovering effective work redesign as well. In all, says Massachusetts Institute of Technology professor Paul Osterman, nearly 80% of employers across industries have adopted quality circles, total quality management, team-based systems, or some combination.

The results, though, have been mixed. Too many such efforts lack commitment from the top, or fail to secure worker support from the beginning. Resources—time, money, managerial expertise—go wanting. The sense of urgency fades. And the workplace returns to the status quo—or worse.

This year, I had to downsize my area by 25%. Nothing has changed in terms of the workload. It's very emotionally draining. I find myself not wanting to go in to work, because I'm going to have to push people to do more, and I look at their eyes and they're sinking into the back of their heads. [People] numbing. But they're not going to complain, because they don't want to be the next 25%. —Middle manager at a large high-tech company undergoing reengineering

Is America burning out? The great risk of downsizing and restructuring is that they'll do nothing to change the way we work. Fewer of us simply will work harder.

CAREER BUILDING

Employees, like businesses, must be continually reinvented

A career center at Raychem helps employees move to new jobs within the company

replace hierarchy. Melissa K. Wilcox, a marketing manager assigned work originally designed for three people, says she "would have hit the wall a year ago," but has managed to share old tasks far more effectively with more people in the matrix.

Reengineering proponents say that shouldn't happen. Raymond L. Manganelli, president of Gateway Management Consulting, recalls an assignment at his own first job—securing signatures of 17 managers who had to authorize a computer requisition. It took three months. New technology, delayering, and fewer people, he says, should cut out that sort of fat: "People don't do more work. They do more valuable work."

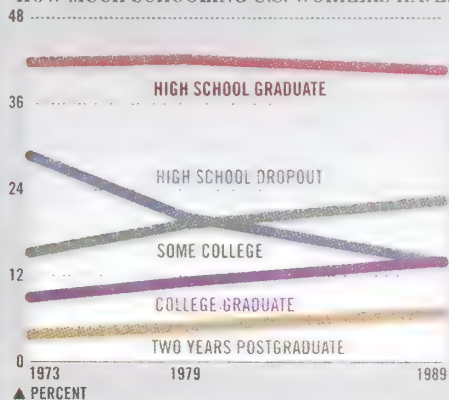
Insurer USF&G Corp., for example, has cut staffing by 48% in five years—but instituted a matrix organization to



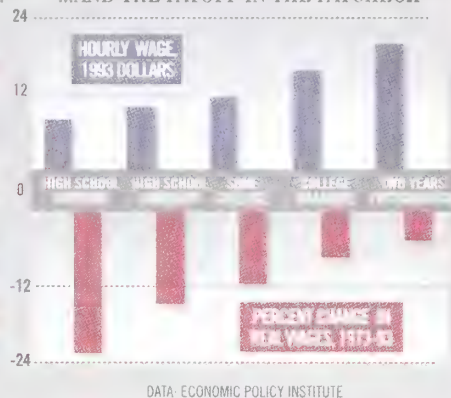
THE EDUCATION GAP

U.S. workers are becoming better educated—and they'll need the sheepskins just to keep their heads above water

HOW MUCH SCHOOLING U.S. WORKERS HAVE...



...AND THE PAYOFF IN THE PAYCHECK



Yet many managers report that, between mass firings and coping with the mound of work still remaining, job stress is pervasive. And an annual survey of managers by the American Management Assn. finds widespread erosion of morale at companies with job cuts. Says Jerome M. Rosow, president of the Work in America Institute: "Where the focus has been on downsizing, getting lean and mean, the effect on managers has been very severe."

This is the bleak underside of the new workplace: For every empowered employee,

there's at least another cowering in his office, putting in long hours to keep up with a job that used to keep two people busy. For every highly skilled worker moving up the ladder, there's another, marginalized, struggling to make ends meet.

FUGIT. A quarter of those employed today do so on a temporary, part-time, or contract basis (chart). The number of Americans working part-time has grown by 2.2 million since 1973—entirely a function, according to the Economic Policy Institute, of more "involuntary" part-timers who would prefer to work full-time. Hundreds of big companies, moreover, have outsourced noncore operations: Continental Bank Corp. contracted its legal, audit, cafeteria, and mailroom operations to outside companies. In September, American Airlines Inc. announced it would do the same with customer-service jobs at 30 airports.

Outsourcing can work wonders for the bottom line: Solid contingent workers get pay comparable to full-time employees, but without benefits that typically add 40% to labor costs. A contingent workforce, too, is more flexible: When business sags, the temps go first. Blue Cross/Blue Shield of Michigan cut its workforce by 40% over five years without laying off a single full-timer.

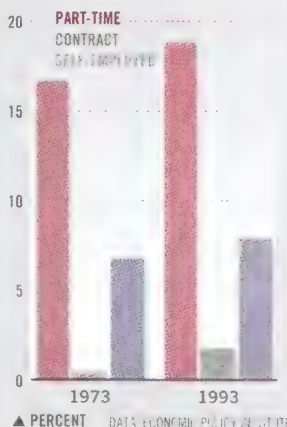
Job dislocation, though, has its price. In her 1992 book, *The*

Overworked American, Harvard University economist Juliet B. Schor estimated that, in attempting to maintain their standard of living in the face of declining compensation, workers spent the equivalent of four weeks more a year on the job in 1989 than they had two decades earlier. A large part of the increase came from the flood of women into the labor force in that time: Their participation rate shot to 57.4% from 42.7%. In many families, that has more than compensated for a decline in hourly earnings. But the addition, clearly, has brought its own pressures.

For the most part, recent studies indicate, the two-income family hasn't figured out yet how best to balance jobs with kids and housework. And despite efforts by many employers to provide child care and eldercare, employees voice frustration with the juggling act. "Unfortunately, the reality and logistics of being a working mother—or involved father, for that matter—have not become any easier," complains Aimee B. McCrory, president of an investment management firm in Houston and mother of two. "I mean, most parents work, and yet the P. T. A. meetings are still at 10 a.m."

THE NEW CONTINGENT WORKER

Employers are pushing more people than ever into the organizational fringes. Part-time, contract, and self-employed workers are rising as a percent of total employment.



I'm grateful to have work, and I'm happy with what I'm doing. I do a good job for them because I feel an obligation as a contractor. But I don't feel loyalty, not the old-fashioned sense of loyalty we used to have. It's the realization that it's just not going to be the same ever again. —Joan Young, Catonsville, Md., laid off from her job as a bankruptcy collection agent, then taken on again as a contractor

Henry B. Schacht, chairman of Cummins Engine Co., is worried. Two years ago, his company reopened a factory in Columbus, Ind., to build midrange truck engines. Workers at Cummins' other Columbus factory,

which produces heavy-duty engines, make \$17.60 an hour under union contract; those at the new plant average \$8.75. They're trained in statistical process control and engine technology and maintenance, and tested for math ability and communications skills. Pay increases are predicated on completing coursework.

Special Report

Schacht wonders whether it will fly. He turned Cummins around with a combination of hard-nosed cost-cutting and progressive high-performance work systems. Now, "we have fewer people doing much more work, much of which is knowledge-based, and we're paying people less," he says. How will Cummins reward employees enough to keep them committed? How will it create promotion paths, now that many middle management jobs have been eliminated? What's going to give?

How, in short, will the new compact work? Schacht expects that companies will have to expand use of employee stock ownership and profit sharing plans. Raychem Corp. has another answer—the "career-resilient workforce," as consultant Robert H. Waterman Jr. describes it. The strategy acknowledges that job skills, like businesses, are ephemeral, and that employees themselves must be continually reinvented. It recognizes, too, that it has a responsibility to help workers sharpen existing skills or take on new ones, even if such programs eventually lead employees to other companies.

No one at Raychem has a job for life. Nothing is guaranteed except the opportunity for self-improvement and the promise that breadth of skills and experience are valued. An in-house career center offers training in interviewing and resume writing and assists employees looking for new posts within the Menlo Park (Calif.) industrial-products maker. The payband

COMMENTARY

By Jack Patterson

WELCOME TO THE COMPANY THAT ISN'T THERE

In computerese, a virtual disk exists only in the computer's memory; when the computer is turned off, the virtual disk is obliterated. By analogy, I suppose, people who work for the new virtual corporations can be called virtual employees. What happens to these people when the power is turned off and their virtual employer disappears? Do they vanish along with the electrons? Are they put together again somewhere when some chief executive loads another virtual corporation into memory?

It's an uneasy vision—at least from the vantage point of one who has spent his entire working life in the real-world offices of desks, typewriters, overflowing ashtrays, and overturned coffee cups. This new world of work is shaping up as a far scarier place than the one my generation labored in. It's riskier, less dependable, more anxiety-provoking. For the foreseeable future, younger people will find jobs harder to obtain and harder to hold onto. Those who survive and thrive will need a daunting array of new skills and make themselves a lot more adaptable, independent, and tough-minded than those of us who came along decades ago ever imagined.

PROFESSIONAL PRIDE. For more than 30 years, I worked for one employer. The location and appearance of its offices changed occasionally, but there was always one reassuring constant: Whenever I took a stroll around the floor, I encountered other people who were—in various degrees and combinations—talented, stubborn, knowledgeable, irritating, interesting, and opinionated. We were reasonably sure that if we performed satisfactorily, our jobs were more or less secure. What's more, a sur-

prising number of us served out our full sentence. My crowd was fortunate to be nearing retirement age by the time "restructuring," "reengineering," and all those other bloodless euphemisms for wholesale bloodletting became the rage among American corporations.

My fellow workers and I argued a lot, but we learned a great deal from one another. What bound us together was mainly our commitment to a common goal: to produce the best product we could. Keeping the paychecks coming was certainly one motive, but more than that, we wanted to keep our own and one another's respect. We called it professional pride. On days when our product emerged, despite the feeling that this or that could have been done better, an almost palpable sense of satisfaction and accomplishment pervaded the office.

No standing around the water cooler, exchanging stories, and maybe learning something useful

Freud was only one of many thinkers who have pointed out that work (along with love) is one of the essential sources of self-esteem and meaning in life. Some work is brutish and degrading, of course, but advanced societies offer more people more chances to work at jobs—whether modest or top-drawer—that allow them to make use of whatever

talents they have. And the almost biological imperative to find meaning through work is at the core of the longstanding compact between worker and employer. The primary job of a manager, it has been noted, is to induce his employees to make their best efforts to do the job he wants done. Some try to do this by instilling fear, but the task is easier if employees want what management wants. And that's more often the case when the job provides some reasonable level of psychic reward.

Yet much of what is taking place in today's world of work is weakening and even breaking the traditional bonds between employers and their employees, and among employees themselves. The nonmaterial rewards that come in large measure from collegiality and commonality of interest are diminishing.

FREELANCE NATION. More and more companies are turning to an "interim" workforce—temporary, freelance people who can be called in or sent home as the employer requires. Some companies are dispensing with proper offices; employees work at home, on the road, or occasionally drop by some all-purpose cubicle somewhere to plug in their laptops. No standing around the water cooler, exchanging stories, and maybe learning something useful from a co-worker.

Then there are the virtual corporations comprised of transitory teams of people who deal with other transitory teams, all of whom must take the others' competence, honesty, and reliability on faith.

No reasonable person can quarrel with the idea that managers' primary obligation must be to keep their companies competitive in a global economy. But can the needed productivity and

CEO Saldich: "We get a person who is fully engaged, is excited about what he or she is doing—a much more productive, dedicated employee."

certainly, education forms a foundation for the new workforce: The continuing growth in professional and technical occupations will demand ever-higher capabilities of Americans. Says Joe Lo Galbo, a Ford Motor Co. machinery airman-turned-trainer: "The auto worker is almost a scientist in a technical way. He's required to know so many things, he's required to know so much." Ford offers workers up to \$3,100 a year toward tuition for approved courses. FordSignal Corp. sent all 86,000 employees through a four-course on total quality and is gearing up for a second session.

Even so, at 1.4% of payroll, U.S. employers are spending very little on training. *Training* magazine says formal development spending by U.S. companies with more

than 100 employees, at \$50.6 billion this year, will be up just 11% from 1990—less than inflation.

Economists and executives worry, too, whether all the training, reengineering, and empowerment are sustainable. We increasingly demand that our workers take on responsibility and risk, yet their pay is falling. Will \$8-an-hour machinists do high-performance work? "The real answer is, we don't know yet," says MIT's Osterman. "But you can't expect workers to keep contributing their ideas when they don't get rewarded for them."

The new compact still binds employer and employee in a web of loyalty and mutual responsibility—a blend of community and autonomy. But it no longer protects from the reality of competition. Perform, it demands, and we shall see. Share in the risks. No guarantees.

By Keith H. Hammonds in New York, with Kevin Kelly in Chicago, Karen Thurston in Atlanta, and bureau reports



quality gains be achieved by a workforce that is angry and fearful? Won't employees who feel isolated, indifferent, and insecure define their self-interest as narrowly as too many companies now do?

Despite my advancing years, I am not arguing simply that the old ways are the best ways. In many respects, new is better. The people working in my former office these days are a far more diverse group, racially and by gender, than when I worked there. And I think they are more open to change than we were. Moving to new technology, such as from typewriters to computer workstations, flummoxed many of us years ago, but it doesn't frighten them a bit. For one thing, experience has shown them that while new technology forces some changes in their work habits, people can find almost as many ways to force technology to adapt to them.

QUAINT RELIC. The danger I see is that the intangible but indispensable values I discovered at work will be lost: the sense of community, the shared goals, the spirited exchange of ideas, the pride of achievement. They are not, I admit, the concepts managers generally use to measure employee performance. But without them, I think, permanent gains in efficiency and quality will be difficult or impossible to achieve.

Some people, no doubt, welcome the new way of working, with its greater flexibility and freedom. And in time, most jobs will be held by young people who, if they have even heard about the kind of office I worked in, would regard it as a quaint relic. By then, management will probably have discovered the answer to the question that bothers me: whether the gains delivered by the new here-today-gone-tomorrow working environment are lasting or as evanescent as the information on that virtual disk.

Jack Patterson retired as editor of the editorial page in 1987.



BUSINESS ROLLS THE DICE

In the new U.S. economy, the risks are greater—and so are the potential rewards

Since the Great Depression, work has been a place where both employers and employees strove for certainty. Workers wanted a secure job and a steady income. In exchange, companies expected to keep control over what is perhaps their most critical resource: their employees.

All that has changed. Job security has virtually vanished, as the pain of downsizing continues to rip through the U.S. Over the past year, almost 600,000 new job cuts were announced—and this in an economy growing at a buoyant rate of 4% annually. At the same time, switching careers—even in middle age—is becoming commonplace.

Those who aren't losing their jobs are finding conventional notions of security undermined as corporations rethink the nature of work itself. Changing the traditional workplace promises great benefits to both workers and employers in the form of greater productivity, better quality, more flexibil-

ity, and higher profits and wages. But it also brings great risks. For workers, the evolution of the workplace can mean giving up the security of a comfortable office, a permanent job, a set income. Employers may be forced to yield some measure of control over their workers to achieve the productivity gains they need.

Why are U.S. businesses and workers ready to overhaul the way work has been organized for the better part of a century? Simple necessity. After 20 years of slow productivity growth and falling real profits and wages, the U.S. faces the daunting prospect of intensified global competition. American corporations are forced to look for ways to boost productivity and cut costs, even if it means accepting more uncertainty in the workplace. It's no different from the financial markets: As every smart investor knows, higher returns usually mean higher risks.

NO INVENTORY CUSHION. Indeed, the revolution in the workplace is part of a broader movement across the entire U.S. economy toward accepting greater risks in exchange for bigger gains. Look at the evidence: Americans are going entrepreneurial with a vengeance, with the rate of new business incorporations hitting an annual rate of 737,000 in the first four months of 1994—the highest rate ever. Investors have poured some \$160 billion over the last 18 months into foreign stocks and bonds, seeking higher returns at the expense of greater risks.

Many corporations, too, are rolling the dice, taking risks not only in the workplace but also in their capital investment and strategic decisions. Billions are being committed to creating the Information Superhighway—from fiber-optic cable to world-spanning satellites—without any guarantee that a profitable market will ever exist. The widespread adoption of



INVESTING

Americans are pouring billions into foreign bourses, tolerating more danger for higher returns

The Philippines stock market has gone up some 50% over the past year

just-in-time production has mostly eliminated the cushion that inventories used to provide. And looking abroad, any U.S. company with investments in China or Russia knows full well that these transitional economies could become inhospitable to capitalism overnight.

Still, the new willingness to take risks is already showing results.

activity has surged, and the U.S. has regained its leadership in key technologies, according to a new report from the Council on Competitiveness. Wages and salaries, adjusted for inflation, rose 3% over the last three years, their best sustained gain since the early 1970s. And corporate profits, in real terms, have surged to historic highs.

At the downside is that the U.S. economy has not yet found ways to protect people from the increased risks they face. Instead, the current tax and health-care systems actually penalize job-lossers and career switchers. Moreover, the workplace no longer offering a safe haven, workers eventually require the protection of new markets, similar to insurance against fluctuations.

Until such mechanisms are in place, many workers will find themselves grappling largely on their own with the risks and rewards of the transforming workplace. One key change, already under way, is the decrease in pension plans that require workers to pay a set amount at retirement—the so-called defined-benefit plans. Only 56% of workers are now covered by defined-benefit plans, down from 84% in 1982. Instead, companies are moving to de-

such as 401(k) plans, which give workers a set amount of money each month to invest for retirement.

Clearly this shift has created new risks for workers, since their retirement income now depends on how well their investments do. What's less widely understood is that, invested wisely, a 401(k) or other defined-contribution plan can do better than a pension plan that pays fixed benefits. Consider: Many pension funds gained from the stock market boom of the 1980s. Yet companies did not raise their promised pension benefits. Instead, the higher investment returns enabled them to cut their funding of pension plans. With a 401(k) invested in equities, it's the workers who receive the gains from a rising stock market, not the companies.

As employees adjust to the new realities of the labor market, the same trade-off between higher risk and increased return shows up over and over again. Take the increasing use of temporary or contingent workers, outside consultants, and subcontractors to replace laid-off full-time personnel. This means that many Americans, while still working, have been shoved outside the security blanket of big companies.

Yet that isn't all bad news. According to new research from economist Andrew M. Yuengert at Pepperdine University, on average self-employed workers earn about 40% more per hour than those working for someone else. Moreover, capital invested by the self-employed in their own businesses can pay high returns compared with most other investments.

At the same time, the employer faces new risks in hiring outside workers. Historically, successful corporations have relied on the knowledge embodied in their workers as a critical corporate asset. Yet outsourcing removes that competitive advantage. "If they're buying services on the market, everyone has access to them," says William Lazonick, an economist at University of Massachusetts at Lowell.

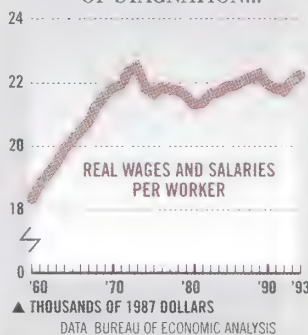
ESCHEWING THE SAFE COURSE. Even with these pitfalls, the shift to the new workplace is a gamble that needs to be taken. Clearly, the old ways of work aren't working well anymore. By most measures, the economy has stagnated since the early 1970s. Productivity growth slowed to a crawl, real wages and salaries stopped rising, and the trade deficit widened sharply. And the prospect of even more intense foreign competition is making change easier to accept for Americans.

Certainly workers and companies are more willing to experiment with new forms of work, even as the U.S., overall, shifts to a high-risk, high-return economy. Investment in foreign stock markets has soared in recent years, for example. These markets are far riskier than their U.S. counterparts, and it's possible to lose money fast. But the returns from investing in foreign markets can be staggering: The Philip-

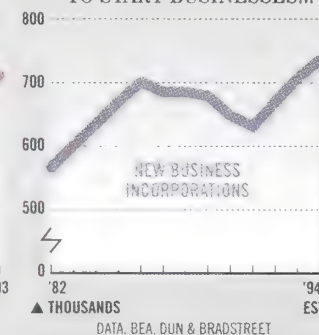
TAKING CHANCES

For workers as for corporations, global competition and technological change are making higher returns hard to come by. The upshot: Individuals must shoulder more risk to achieve greater rewards.

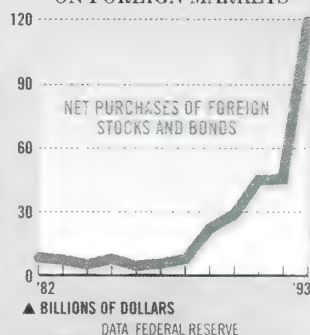
AFTER TWO DECADES OF STAGNATION...



...MORE AMERICANS ARE WILLING TO START BUSINESSES...



...AND PUT BIG BETS ON FOREIGN MARKETS





PRODUCTIVITY

The U.S. has regained its No. 1 position in key technologies, and profits have surged

Hewlett-Packard plant: The company has aggressively promoted new products

rewarded and others who are just struggling to get by. Unfortunately, the institutions that would allow workers to manage that risk effectively have not kept pace. Take medical care, for example. With President Clinton's health-care reform initiative on hold, health insurance is still tied closely to the workplace. That means that anyone forced out of a job runs the risk of losing coverage for preexisting conditions, or worse, living without health insurance at all.

INCOME-FLUCTUATION INSURANCE? The tax system, too, could be changed to impose less of a burden on workers trying to show flexibility in the new economy. Under current tax law, the IRS allows people staying in the same position to write off the cost of continuing education. But for the person trying to switch careers, the cost of training and education is not deductible.

Longer-term, economist Robert Shiller of Yale University has proposed creating new markets where people could buy insurance against income fluctuations. "Companies can't give them that kind of security," says Shiller. "They need hedge markets." Such a market would enable people to take bigger risks with less worry of going bankrupt.

With or without such innovative safety nets, companies and workers will have to embrace risk wholeheartedly. In today's brave new world of work, you have to take the plunge if you want the chance to gain.

By Michael J. Mandel in New York

the pine stock market, to name one, has gone up some 50% over the past year.

U.S. companies, too, are expanding overseas at an accelerating pace, willing to chance political and economic turmoil in exchange for a shot at high profits. In 1993, U.S. businesses invested \$58 billion in foreign operations, double the level of just two years earlier. So far in 1994, investment overseas is running at a rate that would top \$65 billion.

At home, U.S. companies are showing themselves more willing to take large-scale technological risks. Intel Corp. and Hewlett-Packard Co. are held up as models to be emulated, in part because

Special Report

they are willing to take the risk of investing billions in creating and promoting new products, even at the cost of cannibalizing existing lines. By contrast, IBM struggled in the 1980s because it took the "safe" course and tried to protect the profits from its mainframe computer business.

On a smaller scale, U.S. manufacturers have embraced just-in-time methods because they reduce inventory costs and raise quality. But what's less appreciated is that just-in-time creates new risks.

"Even small traffic jams can delay your materials and shut down your plant," says Eric Johnson, a management professor at Vanderbilt University. And if suppliers run short of a crucial part because of excess demand or a strike, then production can quickly grind to a halt.

With all this new acceptance of risk in the American economy, it's not surprising that the accelerating pace of change in the workplace is creating winners and losers, people whose skills and talents are being

ENTREPRENEURS

This year, the rate of new business incorporations hit 737,000—the highest ever

The self-employed earn about 40% more hourly than those who work for others





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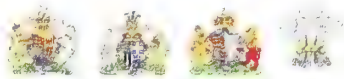
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They're the ones that weren't chosen Four Wheeler of the Year.



DEFENDER 90

THE WINDS OF CHANGE BLOW EVERYWHERE

A more efficient global workforce may mean a wider gap between haves and have-nots

Look at how work is done at software house Infosys Technologies Ltd. and you'd think you were in Silicon Valley. From its use of high-speed networking to its flexible management, the Bangalore (India)-based Infosys resembles California rivals more than India's traditional hierarchical behemoths. "We don't really have a structure," says Deputy Managing Director Nandan Nilekani. "Depending on the job, teams form, do the work, and then disband."

Or turn to the sleepy agricultural region of Basilicata in southern Italy, where auto maker Fiat recently opened a \$2.9 billion plant in one of the most ambitious attempts yet by a European manufacturer to shake off hidebound work practices. Fiat spent \$64 million training workers and engineers to operate in independent, multiskilled teams. Factory workers and office staff now labor together under the same roof. Top-down decision-making is dead, says Maurizio Magnabosco, Fiat Auto's personnel chief. "Problems are solved by teams actually working on production."

MOVING FAST. Sound familiar? The winds of change blowing through the American workplace are also gusting abroad. Although change has rarely gone as far or fast as in the U.S., the spread of information technology, moves to flatten hierarchies and empower workers, and rising global competition have begun to force a rethinking of work worldwide. Many economies face massive downsizings. In Europe, recession has left millions unemployed and millions more worried about the future. For Mexico and India, open markets have forced protected industries to restructure even as new work floods in. And while Japanese joblessness is just 3.1%, lifetime employment is now being questioned. The result: a global rise in job anxiety.

Yet if pressures are similar, the ability to adjust is far from uniform. "Huge differences exist in countries' responses to the challenge of finding new ways of working," says Michael Hammer, co-author of *Reengineering the Corporation*. "In much of Europe and Japan, neither workers nor managers are comfortable with the flexibility and rapid change needed."

In moving to flatten management structures and delegate more responsibility to workers, Europe is moving fastest—particularly Britain, Scandinavia, and the Netherlands. Privatized companies such as British Airways PLC and British Telecommunications PLC led the way by slashing management layers and becoming more entrepreneurial upon leaving the government fold. But now growing numbers of companies have revitalized by ending older, assembly-line work practices.

Typical is Sun Life Assurance Society PLC, a Bristol-based insurer managing \$24.6 million in assets. Sun Life eliminated most middle management and reorganized once-isolated customer service representatives, each in charge of a tiny part of processing a customer's file, into teams that handle jobs from start to end. The result: Turnaround time to settle claims



TEAMWORK

Europeans are taking the first tentative steps toward breaking up often hierarchical business cultures

At Fiat, workers and engineers are trained to operate in multiskilled units

was cut nearly in half, while new business grew 45%. But the change is also unsettling. Although team leader Juliette Britton finds work more fulfilling, management cuts mean "there's nowhere else for me to go."

Elsewhere in Europe, experimentation is more limited, partly because the technologies needed to re-order work—voice mail, E-mail, and videoconferencing—are just catching on. But hierarchical business cultures, rigid work rules, and high unemployment also hinder change. Efforts to boost flexibility have aimed at preserving jobs as much as redefining them.

In Japan, attempts to create new work practices are also in their infancy. High telecommunications costs and limited space in Japanese homes have made setting up workers out of the office too expensive. And use of E-mail and personal computers is well behind U.S. levels. Still, there are signs of flexibility. Toshiba Corp. is experimenting with telecommuting for software researchers, while Orix Corp., Japan's largest leasing company, now hires workers short-term to build its branch network. But cautious steps away from lifetime employment won't mean the radical change of American-style reengineering. Japan's white-collar ranks and service firms remain heavily overstaffed and inefficient.



Educational spending has risen steadily, with emphasis on science and math. Between 1975 and 1985, for example, Hong Kong upped per capita spending on secondary school from \$180 to \$810 in current dollars, while Korean spending soared from \$33 per student to \$450 by 1989. Just as important, school attendance has grown. According to the *World Competitiveness Report*, Taiwan now sends 93% of its 12-to-17-year-olds to high school—just below Japan's 96% and above the U.S.'s 92%. Korea has achieved 87% attendance, while Hong Kong has hit 73%. Employers typically add considerable job training, creating a broad, technically-literate labor pool.

OUT OF SYNCH. Some of the laggards are trying to catch up. Governments across Latin America are waking to the need to follow Asia's lead. In Mexico, for example, fears about losing the unskilled jobs on which the country depends to even cheaper Chinese or Indian workers have brought calls to improve education and training, particularly for the 40% of students who don't finish grade school.

Of course, education alone is not enough; if it were, Europe would be better positioned. But the emphasis on general education, and a frequent lack of vocational training, could leave Europe short of qualified technicians. "People are traditionally well-educated, but their skills are no longer in sync with work," says Stéphane Garrelli, professor at IMD, a top European business school. Nor do demographics favor Europe: Outside of Japan, Asian populations are far younger. "The younger the workforce, the more computer-literate," says David Shpilberg, Ernst & Young's head of information technology. "That's a huge advantage in adapting to new technology."

For those unable to adapt, the future looks increasingly grim. Indeed, to global competition and global communications, add another global trend: fear of a growing schism be-



WORKERS OF THE WORLD... GET TRAINING!

DATA: WORLD COMPETITIVENESS REPORT, 1994. RANKINGS BASED ON QUALITY OF PUBLIC EDUCATION, LEVELS OF SECONDARY SCHOOLING AND ON-THE-JOB TRAINING, COMPUTER LITERACY, AND WORKER MOTIVATION. THESE ARE THE TOP 20 COUNTRIES, IN DESCENDING ORDER.

Who has the most qualified workforce? In a ranking combining quality of public education, levels of secondary schooling and on-the-job training, computer literacy, and worker motivation, these are the top 20 countries, in descending order.

change is coming, where will workers be best prepared? key component will be education and training, increasingly seen by developed and developing countries alike as vital to creating adaptable labor forces. That's all the more so as low-level jobs are lost to technology and the remaining jobs demand higher skills. At German communications giant Siemens, for example, semi-skilled labor has gone from 21% of the workforce to 21% since 1962, while skilled technicians have doubled to 37%. The spread of sophisticated production processes and workers' expanding responsibilities mean that even factory work can require more education. On that score, many Asian countries look best prepared.

tween those benefiting from change and those left behind. "In most sectors, the labor force doesn't see technology as a means for upgrading careers, but as the death of their careers," says L. V. Subramaniam, editor of India's *Labour Herald*, a local union newsletter. That sentiment is increasingly being heard all over the globe, as workers and managers alike wonder if we are heading toward a world in which half the population is permanently overworked, and the other half permanently unemployed.

By Jane A. Sasseen in New York, with Robert Neff in Tokyo, Shekar Hattangadi in Bombay, Silvia Sansoni in Rome, and bureau reports

THE RULES OF THE GAME IN THE NEW WORLD OF WORK

Wrenching changes in the workplace have made it both exciting and difficult to navigate

Team workers. Global executives. The multicultural workforce. Virtual employees. Road Warriors. All these terms, foreign to the management lexicon 65 years ago, have been proffered as answers for a nettling question: What is the new definition of a worker in our much-changed world? It's not surprising that the answers are varied. Where you fall in today's employment pecking order—young or old, black or white, management or labor—often determines how hospitably you view the new economic environment. Technology that allows employers to do more with less, for example, has become both the worker's friend and foe—de-

pending on which end of the downsizing ax you're on. And the economic blessings that stem from America's steady march toward a "knowledge workforce" can become a personal curse if you don't have the advanced skills needed to keep up. Just as the U.S. economy has been changed by global competition, so has the nature of work been changed by the rush for efficiency and the end of the corporate family. Here is an intimate look at seven workers who are finding their way in this new world. For them, the revolution in the workplace isn't a matter of abstract management theory. They are living its promise, and its challenge, every day.

FREELANCER:

Have
sharp ax,
will travel

Robert J. Glendon couldn't have been less popular when he parachuted into John Hinckley & Sons Inc. last year. Arriving less than five hours after a bankruptcy judge named him interim chief executive of the Cape Cod-based hardware chain, Glendon immediately began dissecting the company's books and grilling employees. Within days, he phoned Hinckley's president at a World Series game and gave him the boot. Then he shuttered the largest of Hinckley's four stores, laying off 25% of its workforce. Glendon admits he often looked over his shoulder as he walked alone to his car late at night because "they



ROBERT GLENDON Rescuing companies involves firing doubtful and restoring surviving workers' confidence

were ready to strangle me."

For 51-year-old Glendon, it's all in a day's work. As a permanent executive freelancer, he shuttles from ailing company to ailing company, serving as temporary CEO or finance chief and making the tough calls that longtime managers are often loath to make. This fall, he is simultaneously running Hinckley, a Philadelphia restaurant chain called Seafood Shack, and Sanborn Inc., a builder of centrifuges and oil-recovery equipment. Through his affiliation with Recover Group, a small Boston firm specializing in rescuing distressed companies, he has also worked for a computer company, a bridal-gown manufacturer, and a potty-chair maker. "I live for FedEx faxes, and phone calls," he says.

Glendon is a new kind of itinerant executive, a specialist in handling tough jobs at tough times. Four years ago he gave up a 17-year career as CFO of a large New England metals supplier because he couldn't stand the tedious

daily routine. Now, for \$175 an hour, he provides a messy-though-essentially service well-suited to today's economy: nursing wounded companies back to health. With corporate loyalty on the wane, freelancing temping have moved the secretarial pool into the corner office. And insidiously, faced with nasty duty increasingly turn to clients like Glendon. The hardest part of Glendon's career is the intense pressure of the first few days on a new job, he says, while traveling. Companies that hire him are often barehanded. Creditors are clamoring for their money,

SURVIVAL KIT

ESSENTIAL SKILLS

- Ability to listen
- Stomach to deliver bad news

CAREER ADVICE

- Don't wait until it's too late to make cuts

QUOTE

"Invariably, these jobs require a reduction in force, and I've got to decide who's good and who's bad"

suppliers are refusing to deliver, and employees are angry or scared—or both.

So the need for speed often eclipses the social niceties. "Invariably, these jobs require a reduction in force,

and I've got to decide who's good and who's bad," he figures. So, after marathon interviews with existing managers, Glendon tries to fire deadwood within the first two weeks—in one case, that was 60% of the company. He then works to rebuild the survivors' confidence. "I tell them I know nothing about their business, and I need their help," he explains. "If they still resist, I remind them they'll still be here when I leave. That almost always works."

While Glendon enjoys helping revive companies, it's difficult being in constant motion. He routinely lives for days at a time in unfamiliar

hotels and logs thousands of miles a month in his car between jobs. "Just as I form roots one place, I'm off to the next," he says.

Luckily, Glendon's three children are all out of the nest, and his wife of 28 years is resigned to seeing him only on most weekends. "I doubt I could have done this job 10 years ago," when the children were still young, he says. But then again, 10 years ago fewer companies were willing to sign on hired guns like Glendon. Now, thanks to the growing demand for steely-eyed cost-cutters, there's no shortage of work.

*By Geoffrey Smith
in Boston*

TEAM PLAYER: No more same-ol'-same-ol' "

When Julia M. Garcia started work at the Frito-Lay Inc. plant in Lubbock, Tex., 13 years ago, her days were filled with the mundane chore of loading bags of the brand potato chips into cardboard cartons. Like most co-workers, she paid little attention to the plant's quality posted on bulletin boards. And Garcia never thought of questioning what went on beyond the confines of the packaging department where she worked.

Today, three years after the plant introduced work teams, Garcia seems more like one of its managers—rejecting products that don't meet quality standards and sending home excess workers if machines shut down. PepsiCo's Frito-Lay unit, like a growing number of U.S. manufacturers, is slashing the number of middle managers while relying on teams of hourly workers such as Garcia to take care of the daily decisions that can dramatically boost quality and reduce costs.

Worker empowerment can yield dramatic results. At the Lubbock plant the number of managers has dropped from 13 since 1990. The hourly workforce, meanwhile, has risen by over 20%, to about 220. And despite less supervision the plant has logged double-digit cost cuts and seen its quality jump into the top six of Frito's 48 U.S. factories, from bottom 20, since adopting teams, says Director of Operations Andrew G. McCain. Garcia, once a supervisor in a now-defunct Strauss & Co. factory, was no eager convert to the team concept. "It kind of frightened me at first," she admits. "I thought, 'I'm going to be able to decide anything.'" Some colleagues feared the changes would mean more work and less time to do it. But now says Garcia, "I really enjoy [the team approach] because it gives me a sense of pride. I know my work and what we need to do." Garcia and the 10 other members of her potato processing team are responsible for everything from potato processing to equipment maintenance.



JULIA GARCIA Her chip-packing job now involves interviewing new hires and making quality-control decisions

nance. To help them devise ways to produce and ship chips more efficiently, Garcia and her teammates receive weekly reports on cost, quality, and service performance and are kept abreast of the team's ranking in relation to Frito's 22 other potato-chip teams nationwide. Garcia's group, at the top of Frito's rankings for more than a year, also determines crew scheduling and even interviews potential employees for the department—once the sole domain of management.

Garcia herself has become more versatile as a team player. She has learned other positions in the plant so she can fill in as a "headsetter," operating the machine that slices the potatoes, or as a quality-control technician monitoring the spicing on the chips. "It's more fun," Garcia says approvingly of her team job. "It used to be it was just the same-ol'-same-ol', [but] now there are more things happening."

Of course, wielding authority isn't always

SURVIVAL KIT

ESSENTIAL SKILLS

- Ability to communicate
- Positive attitude

CAREER ADVICE

- Learn several jobs

QUOTE

"You might be doing something that can be improved, but you can't see that yourself. Maybe somebody else can"

easy for the team workers. "Sometimes we have to tell some of our co-workers who aren't carrying their load that this is hurting us," explains Garcia. That's a dramatic turnabout from the old days, when workers would never complain directly to one another

Special Report

but instead might gripe to a supervisor. But now, says Garcia, "we've all worked so close together that it's just like telling your kids at home to shape up."

Although Frito hasn't yet tied individual pay to team performance at the plant, Garcia is already eager to expand the team process. "This is my job. This is where I spend half my life," she explains. "And I want it to be a good place to work."

As much as her job has changed, though, Garcia hesitates for a moment when asked if she would want her two granddaughters to follow in her footsteps at Frito-Lay. "I'm sure I would—as managers," she replies.

By Wendy Zellner in Lubbock, Tex.



THOMAS HUBBS When no phone jack is available, he uses screwdrivers, pliers, and alligator clips to invade the nearest handset or face plate

VIRTUAL WORKER: Anyplace I hang my modem is home

It's just another day at the office for Thomas W. Hubbs, vice-president and chief of staff at VeriFone Inc. So please don't mind the towel racks, the shower curtain, and those tiny bottles of shampoo. Hubbs sets up his "virtual office" wherever it makes sense on any given day—even in a hotel bathroom, if that's the only place a phone jack for his laptop computer can be found.

For Hubbs and other employees of \$260 million VeriFone, which dominates the

market for credit-card verification systems used by merchants, home is where the data port is. Advances in computer and communications technology have spawned this new breed of nomadic executive, untethered to any particular office building or city. And their ranks are sure to grow as more businesses push to shorten management response time while keeping staff lean.

While VeriFone's nominal headquarters is located in

Redwood City, Calif., its peripatetic executives view their primary meeting place as the company's computer network. CEO Hatim A. Tyabji, for example, maintains an office in Redwood City, but spends 80% of his time on the road. VeriFone's senior vice-president for operations is located

in suburban Los Angeles. Its human resources director is based in Dallas. And its chief information officer lives and works in Santa Fe, N. M.—the sole VeriFone employee in town. To maintain some human contact, the company meets face-to-face every two weeks.

VeriFone's long-distance operating style would be impossible without its computer system, which makes every bit of corporate information available on-line, and a management culture that embraces computers for almost every task. Everyone from the chairman to the most junior clerk is issued a laptop computer and is expected to learn how to use it. Internally, paper memos are banned, and secretaries—a rarity at the company's offices—are prohibited from handling an executive's E-mail.

That's why Hubbs, who served as chief financial officer until his promotion in July, carries a standard VeriFone "Road Warrior" kit with him whenever he hits the road. When no phone jack is available, he uses the kit's screwdrivers, pliers, and alligator clips to invade telephone handsets or get behind face plates on hotel-kitchen walls to link his computer to an outside line.

Once connected, Hubbs taps into one of VeriFone's constantly updated financial databases to pull company-wide sales figures, focus on particular business segments, or even look at an individual salesperson's performance that day. Routine capital equipment requisitions can be O.K.'d electronically. If costs are too high near the end of a quarter, he can see on-line what staff additions are pending and use E-mail

SURVIVAL KIT

ESSENTIAL TOOLS

- Laptop computer
- Alligator clips

CAREER ADVICE

- Information is to be shared not hoarded

QUOTE

"You shouldn't use E-mail to express emotions. Fairly innocuous E-mail can set people off"

k the appropriate supervisor if the hiring can be expedited. "I keep up in real time," Hubbs explains. "I have to wait until I'm at the office."

VeriFone even uses its information system to gain an edge in fast-track software development. In what the company calls a "relay race," developers working on "sh" project send unfinished work at quitting time to other development centers in Laupahoehoe, Hawaii. When the sun sets on the Big Island, the project is shipped to programmers in Bangalore, India, for further work. By the following morning, it ends up back in the U.S., 16 hours nearer to completion.

Obviously, VeriFone relies on other mundane technologies to get its work done.

Hubbs, for example, carries a Hewlett-Packard OmniBook laptop with an older Intel 386 processor, while using 386 desktops both at work and at home. He rarely uses his cellular phone to ship faxes or E-mail because "right now the costs are so high it doesn't make sense, except in an emergency." And VeriFone's lynchpin E-mail system runs off vintage Vax minicomputers. "The technology itself isn't that great," admits Tyabji. "What's important is the implementation, the mindset." And that willingness to eschew the traditional trappings of the corporate office in favor of the instant response of the computer age is why VeriFone's virtual office has become an actual success.

*By Russell Mitchell
in Redwood City, Calif.*

LO FLYER: A dizzying plunge to earth

Flight attendant Jon Howard had a dream job in 1985 when he earned close to \$50,000 a year flying Trans World Airlines Inc.'s prestigious New York-to-Italy route. Even after buying a home in swank Boca Raton, Fla., and plenty of cash left over for fun and savings. But less than 10 years later, Howard's life has turned into the 1990s version of a nightmare: His annual income has plunged almost to only \$30,000—and he often works seven days a week for no wage even that. "I don't spend any money, and I worry," Howard admits. "I'd be a fool not to."

Working harder for less pay. Nowhere has that reality more painfully felt than among airlines, where since the late 1980s employees at United Airlines, Northwest Airlines, and others have traded wage cuts for stock ownership. The belt-tightening isn't confined to employees who ply the skies, of course. From auto parts to steel, workers in industries obdurate with cost-cutting are coping with the realities of lower wages, fewer benefits, and less-secure pensions. And companies of every stripe are dropping traditional pensions in favor of self-directed plans, forcing millions to take a more active role in planning—and often paying—for their own financial security. Howard's finances have taken a fiercer beating than most. Now 49, he has had his pay cut twice: a 22% cut in 1989 followed by a further reduction that was part of TWA's 1992 plan to emerge from bankruptcy. To make matters worse, Howard was out of work from 1986 to 1988 when his then-6,000-member union went on strike in opposition to concession demands from Carl C. Icahn. Howard got a catering job, but his savings were decimated. That has left him worried about life after retirement. TWA's pension plan was frozen in



JON HOWARD The veteran flight attendant is sticking with TWA—despite scrambling to scrape up \$25,000 from old jobs.

late 1992 after the federal Pension Benefit Guaranty Corp. declared it to be underfunded by \$1 billion. That means the airline will no longer make new contributions to the \$50,000 in Howard's pension account. Still, the 20-year veteran hopes 45%-employee-owned TWA will survive. "Where would I find something as exciting as this to keep myself going?" he asks.

But sticking with TWA means Howard must scramble to safeguard his financial future. He contributes 10% of his pretax income to TWA's 401(k) plan to supplement the frozen pension. He scrimps to make a \$2,000 annual contribution to his tax-deferred individual retirement account and scrapes up \$200 more each month to put in a savings account at TWA's credit union. Being unmarried and childless helps. Still, he worries whether he's saving enough.

To sock away as much as he does, Howard lives frugally. He drives a 10-year-old car, rarely eats out, and buys most of his clothes at off-price stores. Even hobbies are inexpensive: tending orchids and rollerblading. There's not

SURVIVAL KIT

ESSENTIAL SKILLS

- Frugality
- Willingness to work overtime and save like crazy

CAREER ADVICE

- Don't be afraid to seek outside financial advice

QUOTE

"You have to have a sense of humor; these are difficult times"

much time for those, however. To boost his earnings, Howard often flies overseas three days and then flies another four days domestically. "It's either that or get a second job," he says.

Special Report

For advice on managing his finances, Howard consults

Lucy Sabella, a former TWA flight attendant who became a certified financial planner during the 1986 strike. Now a Dean Witter Reynolds Inc. broker in Lighthouse Point, Fla., Sabella has steered his IRA contributions into a diversified group of

mutual funds, about half of which invest internationally in pursuit of higher returns.

But given Howard's age and income, Sabella has advised him not to take risks on individual stocks. His only direct equity holding: TWA stock purchased mainly with \$10,250 in wage concessions. "I can't even convince some 60-year-olds they have to put money away," says Sabella, but "[Howard] is very diligent about saving every penny he can." No wonder: Like millions who can no longer count on the benevolence or longevity of their employers, Howard has little choice.

By Susan Chandler in St. Louis

PIONEER: The race battle never ends

Debra D. Richards can appreciate the idea of valuing "diversity" in the workplace—one of today's favorite corporate buzzwords. Trouble is, she finds that diversity is still more concept than reality. A 34-year-old black marketing communications manager for a unit of Aetna Life & Casualty, Richards says almost all of the managers in her 290-person Irving (Tex.) office are white. "At times, I think we're making progress toward [a multicultural environment]," she says. "But on a day-to-day level, all I have to do is look around me and look at the people in leadership positions."

In 1982, fresh out of the University of Texas with a degree in journalism and public relations, Richards figured that race would be a nonissue. "When I first started working, I thought everything was going to be fair," with rewards for hard work and talent, says Richards, whose father owned a concrete company and whose mother was one of the first black local managers at Sears, Roebuck & Co. But at her first job with a small Houston public-relations firm, Richards recalls, the president confided that one of the clients had asked why she had been hired to handle his account. With her boss's support, Richards stuck with



DEBRA RICHARDS *The marketing communications manager for Aetna hopes that the company's efforts to promote diversity will translate into opportunities for minorities*

the client anyway. "You have to learn to go on and do the best you can do in spite of those kinds of things," she says.

But even well-meaning coworkers sometimes make remarks that make Richards feel uneasy. For example, at another job, Richards' white boss complimented her for having what he considered a more professional style that contrasted markedly with that of an abrasive local black councilwoman. "I was amazed that he made the remark," she says, because the only reason for the comparison seemed to be that both are black women. "I'm not sure

he took more into the analysis than that."

Richards says that she still occasionally encounters situations where her race appears to color others' per-

SURVIVAL KIT

ESSENTIAL SKILLS

- Self-confidence
- Willingness to voice ideas

CAREER ADVICE

- Find mentors early

QUOTE

"Having a positive outlook allows you to accomplish much more than looking at the negative aspects of situations"

ception of her abilities. Some of the outside vendors she works with at Aetna, for instance, "don't think I completely have the authority to say yes or no to what they're doing," Richards says. If she weren't a black woman, "perhaps they wouldn't question that."

That may change as people of color advance with Aetna. But Director of Workforce Diversity Yvonne Alvarez admits that the company has "a long way to go" in recruiting and retaining women and minorities in the management ranks. About 35% of Aetna's officers and managers are women, and 6% a

shades of success.



Color Me Beautiful works with hundreds of colors. IBM helped them enhance one: Green.

Five years ago, at our first meeting with Steve DiAntonio, President of Color Me Beautiful, he told us quite frankly:

"We're in the cosmetics business, not the technology business."

Five years later, with a 40% annual increase in sales and cash flow, Steve and his company are turning others in the industry a soft shade of envious green.

Back when Color Me Beautiful outgrew their computer system, they began interviewing technology vendors.

And no, IBM was *not* the most expensive. In the words of Lee Nelson, CFO, "We shopped around. Not only were they very competitive, but the guys from IBM talked about tailoring a system

for our specific situation. Others wanted to take a more off-the-shelf route."

Together with Color Me Beautiful, we developed a business plan that's being followed to this day. It involves managing inventory, electronic order-writing, point-of-sale, plus all distribution and delivery.

"The best part," Lee adds, "is that if I have a question or a problem, I make a single phone call and IBM is there."

No matter what *your* favorite color is, we and our Business Partners can help you stay very much...in the black.

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minorities, she says. "It's growing very, very slowly on the minority side," Alverio

fortable promoting white men. That sort of barrier is hard to break."

Special Report

says. "We need to do better."

To that end, 18 months ago Aetna put in motion a major effort to promote diversity of all kinds in the workplace and to tie managers' bonuses in part to how well they hire and retain women and minorities in their units. Richards is certainly hopeful that her company's diversity efforts will make a difference. And in a way, they already have: One of the reasons Richards transferred into her current position last January was because, at the time, the chief operating officer of her unit was a black woman. Nonetheless, Richards says: "There's still a network in place that feels more com-

ment is being relocated this month to her operating group's Connecticut headquarters. But Richards' husband of just five months, a local newspaper columnist, wasn't eager to move to the Northeast. So, after weeks of investigating a commuter marriage, Richards recently decided that she'll quit Aetna by early November. "There are a combination of things in life, professional and personal, and all of them have to work together," she explains. For Richards, as for many minority employees, that connection may be a long time coming.

By Wendy Zellner
in Dallas

TECHNO CONVERT: Never met a computer I didn't like

Ever since the first television commercial was pitched by an ad agency, advertising executives have used hand-drawn storyboards to help clients imagine how their high-priced TV spots will appear on the air. Fred Bidwell has a better way: Using his Apple Macintosh PowerBook 165 with Avid Technology Inc. computer graphics software, the president of Malone Advertising Inc. in Akron, Ohio, shows clients what looks like a ready-to-air commercial—before a dollar of video production money is spent.

That's just one example of how technology has touched almost every task and worker at Malone. But don't assume that Bidwell, 42, is some sort of computer geek. Like more and more executives at small firms, Bidwell was forced to adopt technology in the workplace to survive. Now technology keeps overhead down and lets Malone do things faster and cheaper, helping the agency prosper in the shadow of larger rivals. "Technology eliminates steps in the process and keeps you close to the product," Bidwell says.

Just look around the agency. Computerized graphics workstations create layouts that are as professional as full-color magazine ads. E-mail hookups with clients send messages to out-of-state accounts as if they were next door. Voice mail has replaced the receptionist, and computers have eliminated the secretaries. And all employees—down to the mail clerk—have computers, allowing them to do their own filing. Bidwell uses his laptop as a portable office: It holds the agency's financial records, every proposal he has written, and his calendar for the past three years. "Anything I would ever need can travel with me in a briefcase," he says.



FRED BIDWELL In 12 years he has gone from hand-lettering headlines to forging a model high-tech ad agency

Malone has come a long way since Bidwell arrived 12 years ago as an art director. A 50-year-old agency with 60 employees and annual billings of around \$50 million, its clients include Goodyear Tire & Rubber Co. and Kimberly-Clark Corp. Early in his career there, Bidwell hand-lettered headlines—an 8-day process that now takes less than 20 minutes.

When Bidwell became the agency's president four years ago, he turned to technology to help him weather the recession that began in the late 1980s. He got a laptop and made a commitment to putting a computer on every desk, allowing Malone to continue serving accounts that had been handled by offices he was forced to close in Atlanta, Dallas, New York, and Los Angeles.

Today, Bidwell boasts that the agency does more business outside Ohio than it did when it had all those branch offices. And he estimates that the precomputerized Malone of five years ago would have needed 10 additional full-time employees to manage the current workload. Computers have also cut down on Bidwell's travel time—to just one trip a week. Bidwell says he learned the technology by reading, but mostly by trial and error. "We blindly bought

SURVIVAL KIT

ESSENTIAL TOOLS

- E-mail
- Laptop computer

CAREER ADVICE

- Embrace new technology, don't fear it

QUOTE

"If there is a technology out there that can be useful, use it. Technology eliminates steps in the process"



April 1 is April Fools' Day.

April 15 is tax day.

For too many investors,

there's not much difference.

As the proverb says, "A fool and his money are soon parted." An obvious reference to those who make investment decisions without considering today's tax consequences. And precisely why Morgan has created a unique, customized way of managing assets to help you reap higher *after-tax* returns. Using Morgan's proven equity research and a proprietary technology, we ferret out tax-efficient trades. Then based on your investment goals and tax profile, we build the portfolio that'll be most continuously profitable after taxes for you. The tax man will still cometh. He just won't taketh so much away. If you have assets of \$5 million or more, call Richard B. Jones at (213) 489-9339 or call George W. Rowe at (415) 954-3200, J.P. Morgan California. **Private Banking** **JP Morgan**

a computer to do graphics, and screwed it up," he says.

Still, technology has its limitations. Bidwell used to carry a pager, but he gave it up because being too closely in touch with clients made it almost impossible for him to manage his

time. Now he checks his voice mail four times a day and re-

turns calls when he's ready. He confines his cellular-phone use to taking calls on schedule changes.

Bidwell's advice to the technophobe? If there's a use for use it. "We thought we were in a creative business," he says. "I don't think anyone saw what technology could bring to an ad agency." A techie couldn't have said it better.

By Nancy Peacock in Cleveland

Special Report



JOAQUIN CARBANAL *The BellSouth exec makes deals on his own, adapting to the environment of the moment*

GLOBE TROTTER: If it's 5:30, this must be Tel Aviv

For security reasons, the BellSouth Corp. executives split into two groups and flew from Atlanta to Bogotá in the dead of night. Lawyers, accountants, and operations specialists by day, on this evening in November, 1993, they were bodyguards for the Baby Bell's bid to provide wireless phone service in the Colombian capital. Joaquin R. Carbanal III held the cargo: the \$330 million offer, sealed in a lead-lined box to block X-rays from revealing the price.

Despite the James Bond tactics, BellSouth's bid lost by a slim \$5 million. Win or lose, such high-stakes deal-making is all in a day's work for global managers like Carbanal, 42, newly tapped president of BellSouth Europe. "You've got to be adaptive," says Carbanal, who recently led BellSouth's winning \$300 million bid to provide cellular service in Israel.

And you can't stand still. To win the Israeli contract, Carbanal logged three trips from Atlanta to Tel Aviv in

four months. At 16 hours a flight, "it's murder." But it's not unusual. Three years ago, BellSouth bid for an Australian contract and Carbanal spent a month commuting. He has made more Atlanta-to-South America trips than he cares to count: "You must be incredibly hardy, able to withstand a lot of time zones."

SURVIVAL KIT

ESSENTIAL SKILLS

- Foreign languages
- Cultural awareness

CAREER ADVICE

- Cultivate a mentor or peer who will keep you tuned into doings at headquarters

QUOTE

"You've got to be incredibly hardy, able to stand a lot of time zones"

Luckily, adaptability is part of Carbanal's make-up. Born in Cuba in 1952, he was sent by his parents to the U.S. at age nine. After a brief stay in an orphanage, he was raised by foster parents in LaCrosse, Wis. A Duke University school graduate, he worked for BellSouth in Miami before becoming a lobbyist. In 1992 he was named president of BellSouth Latin America, responsible for plotting telecom deals south of the border. "Not many lawyers ever get this opportunity," Carbanal says.

But it can be nerve-wracking. "You're on your own making decisions on your own," he says. And he must constantly adapt his business style to the cultural environment du jour—from Latin America's low-key social setting to the in-your-face negotiations that's needed in Israel to Australia's wide-open ways.

Carbanal expects that his wife and two daughters will see more of him in Europe than they did when he was round-tripping from Atlanta to South America two weeks every month. "When you get back from a trip, you have to catch up on Saturday and Sunday with things that have been sitting in your office," he says. As a result, he routinely missed such family events as his wife's birthday.

But the family shouldn't expect him home for dinner soon. BellSouth faces a year-end bidding deadline in the Netherlands, and soon he must develop an expansion strategy for eastern Europe. So Carbanal will have little time to get acclimated to his new location. Luckily, he confides, after a few years as a global manager, "you feel home wherever you are." For global executives, that goes with the territory.

By David Greisinger in Atlanta

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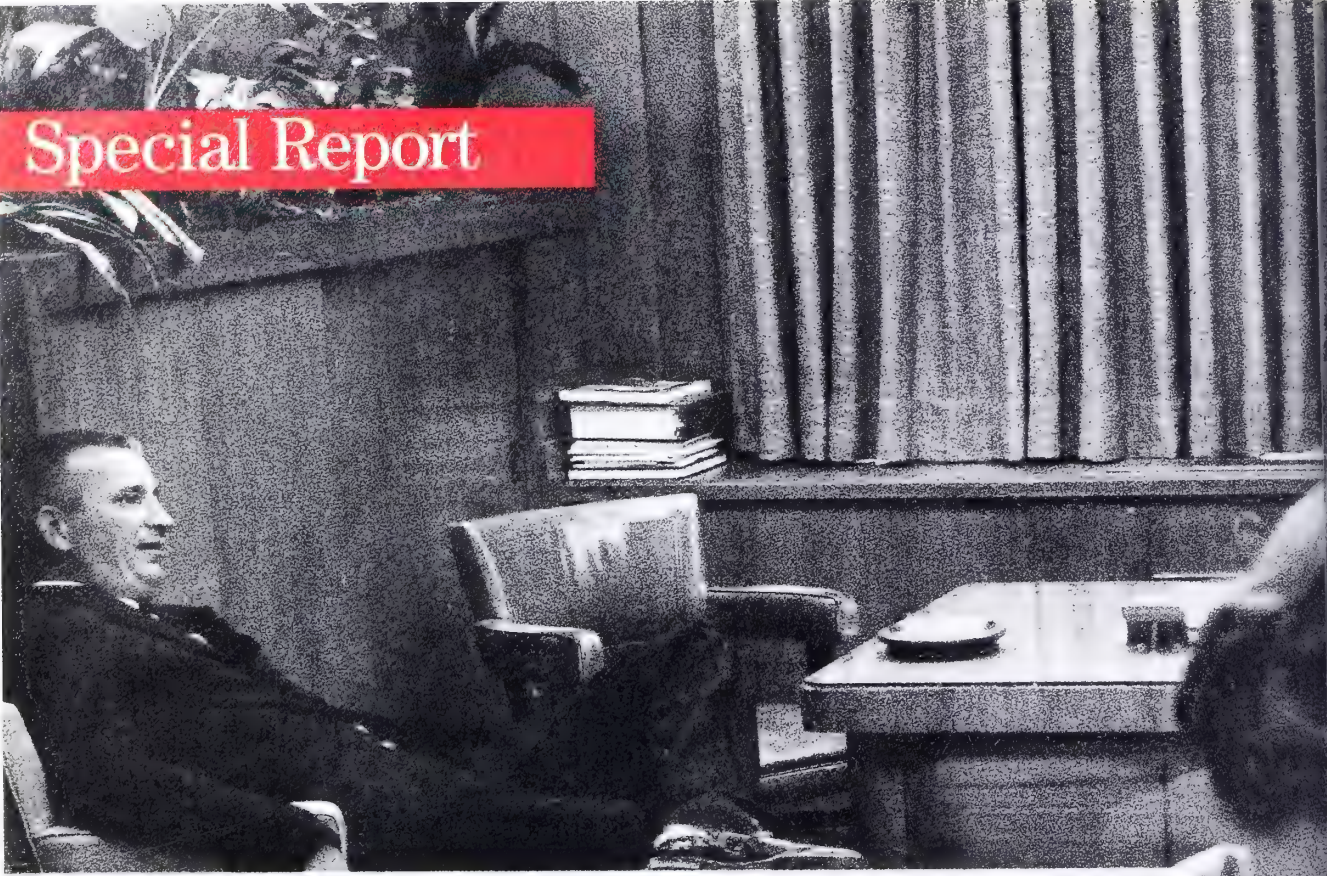
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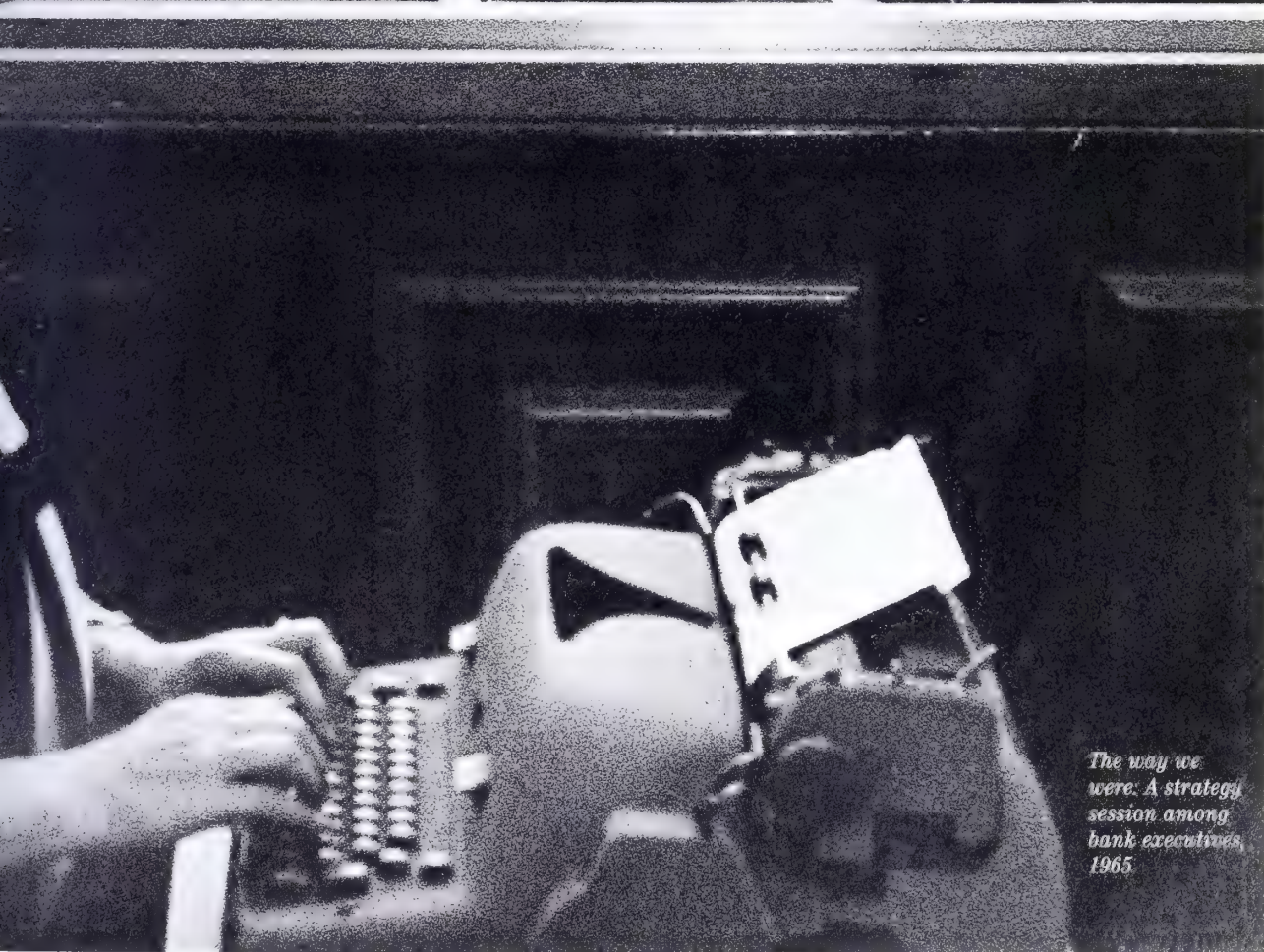


Special Report

A Photographic History

65 YEARS OF WORK IN AMERICA

The worker of 1929 would scarcely recognize today's workplace. The din of the factory has largely given way to the click of keyboards and the ring of cash registers. We take for granted technology that eases our routine, from push-button phones to PCs. The faces at work are different, too: Women and minorities have access to a wider variety of jobs. Managers are ceding the assembly-line mindset: The best supervisors harness initiative instead of barking orders. And from today's vantage point, the labor division between stay-at-home moms and workaday dads is a sepia-toned relic. Here's a look at the changes that have swept the U.S. workplace over almost three generations.



*The way we
were: A strategy
session among
bank executives,
1965*

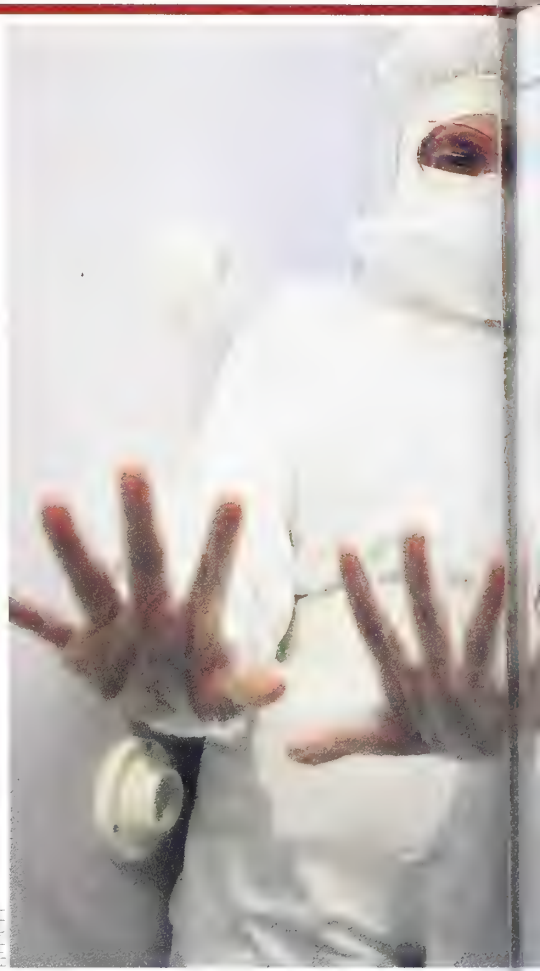
JOBS

Work in the industrial economy of 65 years ago was largely a matter of repetition and muscle. A majority of all workers labored on farms or sweated out the day in a factory or a mine. The post-industrial transformation that began to take hold at the end of World War II has since shifted almost 80% of all jobs to a desk—or to a store or some other type of service.



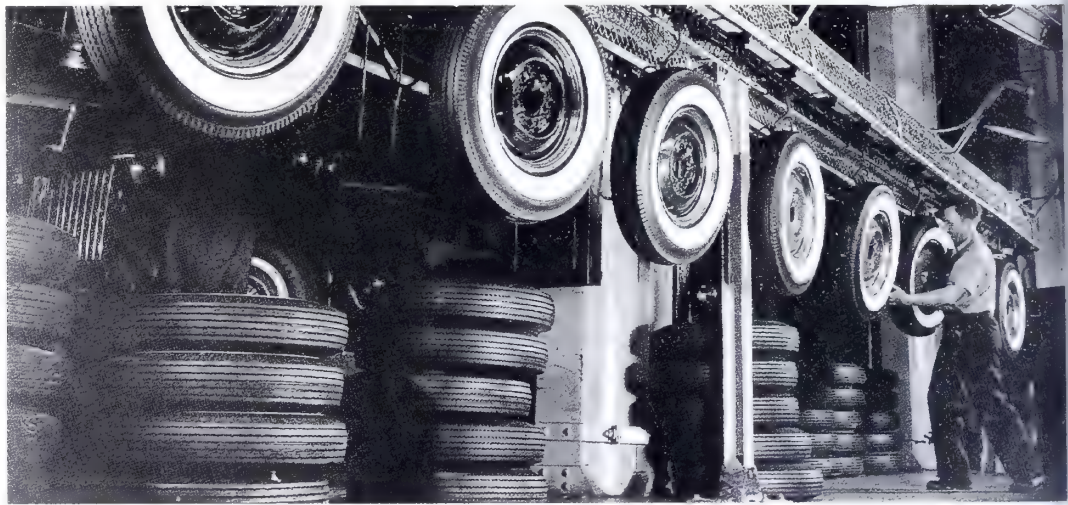
◀ DOWN ON THE FARM

As early as the 1880s, the country had a self-sufficient farm. There were eight million farms, but the rise of corporate agriculture...



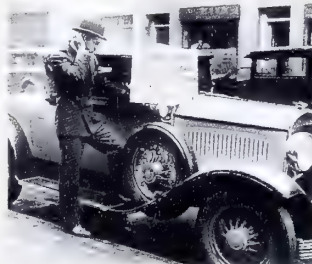
▶ BLOOD, SWEAT, AND TIRES

1940, but a Ford Motor heavily on manual labor.



MILESTONES

The past 65 years have been punctuated by developments that have altered the face of the American workplace. Some of these were specific, such as laws and policies of the 1930s that set rules for employers and employees. More recently, broad trends, such as women going to work and the rising global economy, have had just as great an impact.



1929

The Depression puts 1 in 3 workers on the street. As hard times drag on, no one feels secure.



1930s

Family farm hit by bankruptcy and drought, began to disappear in droves.



Photo: Jeffery M. Hirsch

▲ EMPLOYMENT TO GO

Since the 1960s, jobs have moved from government and health care to retailing and services. The service sector added in the 1980s and provide some 85 million jobs today.

◀ LOOK, MA, CLEAN HANDS

Computers and other high-tech industries increase the demand for skilled workers such as these clean-room staffers.



◀ MARCH OF THE SUITS

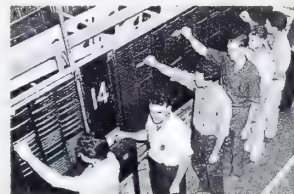
By the 1960s, white-collar work had surpassed blue-collar positions in manufacturing as a source of employment.



In 1935, FDR signs legislation providing for Social Security and unemployment insurance.



Fisher Body workers strike—a sign of unions' growing clout and number, and the protections of 1935's Wagner Act.



In 1938, the eight-hour day and minimum wage become part of basic workplace law.

TECHNOLOGY

Computers and other technologies are remaking the workplace as dramatically as railroads did a century ago. Some 50 million workers tap into computers each day—consorting with faxes, modems, cellular phones, and E-mail. And the factory floor is an eerie landscape of robots and other computer-driven machinery.

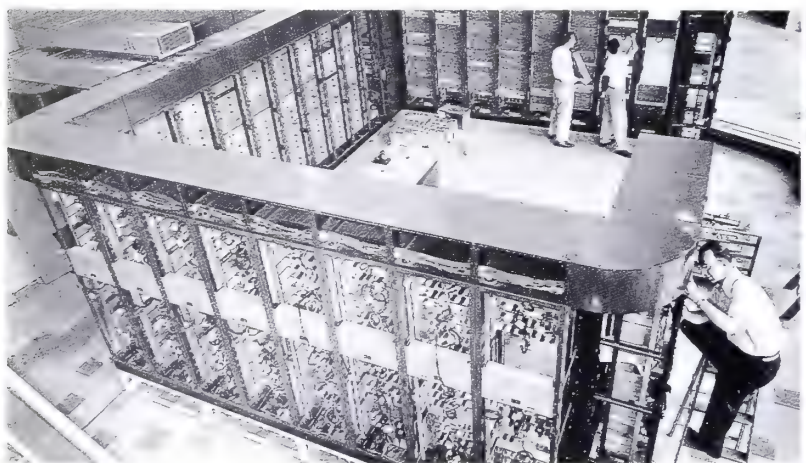


◀ NUMBER. PLIZZ

Even in 1935, when these operators did the dialing, telephones were in their infancy. Touch-Tone and electronic switching were still a ways off.

▼ BINARY BULK

Burrongs' 1955 UDEC II took up a good-sized room, but its computing power was no greater than that of today's best desktop PC.



1940s

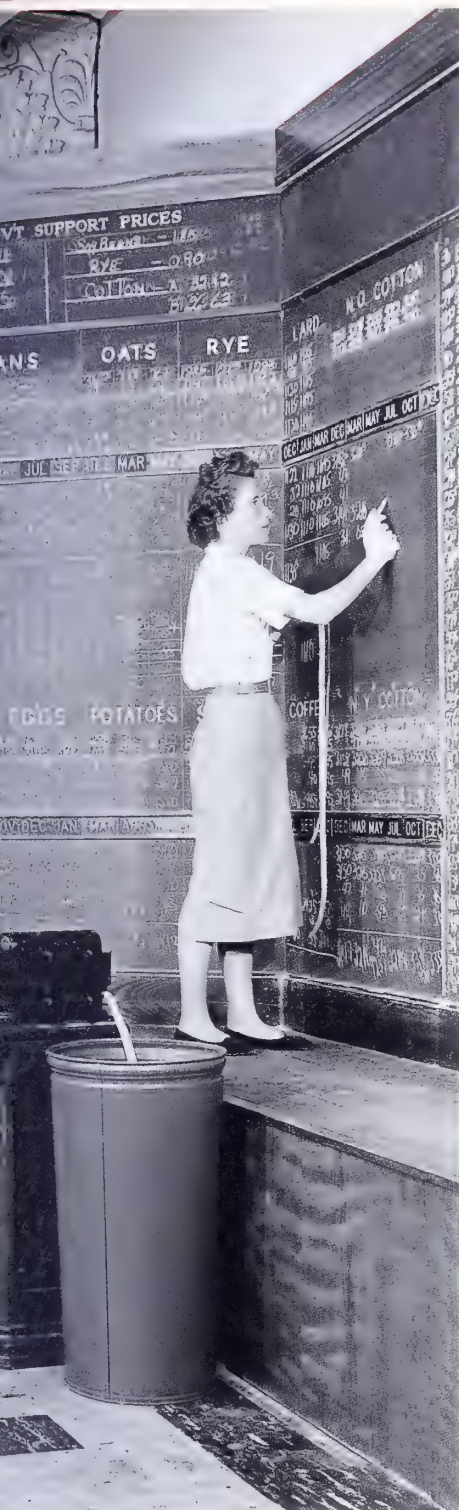
The United Mine Workers' John L. Lewis is among the first to win pensions and health care as standard benefits for labor.



The 1944 GI Bill puts millions of vets through college, upgrading lives and America's skill base.



Throughout the 1940s and 1950s, the economic boom lifts many blacks into well-paying industrial jobs for the first time.



◀ QUICK, MORE CHALK

Wall Street was forecasting a breakdown in market prices for metals, oil, timber and grain, and prices were going to be higher. And so it was by June.

▲ A SCREEN NEAR YOU

The New York Stock Exchange's trading floor is now so computerized that it's impossible to see the traders.

▼ ROBO-DRUDGE

Dr. Jekyll's computerized assistant, Dr. M. D. Drudge, is now the most powerful and efficient of all the computerized assistants.



50s

Meany and Cohn sow a climate of union in the workplace.



The AFL's George Meany and the CIO's Walter Reuther unite to assure greater clout for unions.



1960s

Thriving U.S. industry creates millions of good jobs with generous raises for most workers in most years.



WORKERS

Immigration has altered the composition of the

workforce many times throughout U.S. history. But in recent decades, the most significant change has come from within as women, minorities, and the disabled have sought employment or moved into jobs they wouldn't have been considered for before.

◀ MAN'S WORLD

In the manufacturing-dominated economy of the pre-war years, men

▼ WOMEN'S WORK

The post-war economy saw a shift in the 1940s and 1950s as employment moved from manufacturing to service sectors. This was a major



1960s
Led by Martin Luther King Jr., the civil rights battle highlights minorities' stymied employment status.



1970s
The bulk of baby boomers begin to hit their 20s, flooding the labor force with young college-educated workers.



Oil price shock and resulting inflation prompt many employers to set up cost-of-living increases.



BREAKING SS?

...today are
...breaking into
...per ranks. By
...27% of employed
...were managers
...professionals.



◀ DIFFERENTLY ENABLED

...technology are helping

▲ UP THE LADDER

It's a hard climb. In 1991,
just 7% of employed blacks
were executives or

...rate for whites.



Women's lib,
more single
mothers, and
falling real wag-
es for men spur
rising ranks of
working women.



The shift to a ser-
vice economy
stretches into the
1980s, with its at-
tendant rise of
the superstore.



Earlier retire-
ment alters the
workforce. Today,
16% of men over
65 earn a pay-
check, vs. two-
thirds in 1929.

MANAGEMENT

The job of those managing the workplace is

undergoing a transformation every bit as profound—and wrenching—as the nature of work itself. Heightened competition, both domestic and foreign, has forced managers in the U.S. to rethink the autocratic, top-down approach developed by Frederick Taylor and others at the turn of the century. Now, more and more employers are forming problem-solving teams in factories and offices and relying increasingly on collaborative efforts—both the employee-manager kind and between the company and its suppliers and customers.

▼ HERE'S HOW IT'S GONNA BE

The faces of these IBM plant managers leave no



► BIG WHEEL

Until recently, executives commanded and employees carried out their orders. GM's styling boss inspects a mock-up of



1970s
Yuppies in training: The ranks of doctors, lawyers, and MBAs swell. A class at the J.L. Kellogg School of Management.



1980s
The U.S. meets the global economy. Soaring imports spur closings, layoffs, and wage cuts.



President Reagan fires air traffic controllers in 1981, speeding organized labor's fo



▼ WHO'S WHO?

enter U.S. factories, such as Honda's Marysville (Ohio) plant, worker and

▲ I TRUST YOU

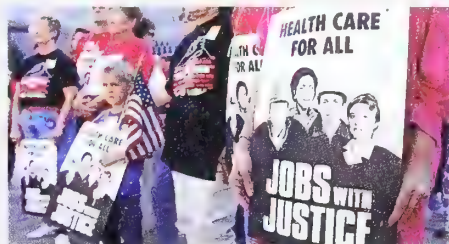
in 1983, still not up to speed in carmaking. To foster teamwork, it often puts through offbeat exercises.



The "Mommy Track" emerges as moms (and a few dads) strive to combine work and family needs.



Tiny memory—but IBM's first PC, vintage 1981, spurred a revolution.



Companies slash health care and pensions in an effort to control spiraling costs.



WORK LIVES

So long, Ozzie and Harriet.

The prewar image of Dad as sole breadwinner has been supplanted by working couples juggling jobs and family and single parents struggling to support their children. Nontraditional workdays have become common, with more than a quarter of the workforce holding part-time or temporary jobs. And what used to be off-the-job issues—such as health, drugs, and fitness—are now the concern of employers.



1990s
The 1990-91 recession sets off restructurings galore and leads to white-collar job-seekers like these, at Georgia's Labor Dept.



The office hits the road, thanks to gadgets such as notebook computers and cellular phones.



Chrysler's "performance" team satisfies Corporate America's appetite for worker empowerment.

◀ GOT A LIGHT?

In 1951, 57% of men were smokers, and so were 28% of women. Three-martini lunch, anyone?

▶ FATHER KNOWS BEST

The family from another planet? No—just your typical American household at the outset of the baby boom.



FEAT EQUITY

Microsoft pays for employees' memberships in health club five miles away from the company's Bellevue office.

PERMOM

In the 1990s, companies' most common perk is one: A programming engineer who brings her baby to the office.



With 401(k)s and other plans, employees bear more responsibility for personal finances.



Companies set up diversity programs to help deal with the rise of minority workers.

PHOTO CREDITS

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Breaking the Mold



by Lamar Alexander



1894



1894

Do you think this has been a century of change?



1894

Go to school.

Here's a scary thought: every industry in America, from our communications to our shoes, has been revolutionized by new practices and technology — except one: education. Why is the endeavor that's supposed to prepare us for the future the one that has fallen behind? And what are we going to do about it?

This fall, IBM is launching an initiative called Reinventing Education to help schools rethink the whole way they approach our kids' education, to get students ready for a future of change.

We will be working in partnership with educators and administrators in public school districts who are willing to give up the conventional assumptions to make our kids the smartest and most capable they can be.

One good example is IBM's first partner, the Charlotte-Mecklenburg School System. Together we're building an Education Village, near IBM's Charlotte plant. It will throw away the old lockstep structure of 12 grades, 50-minute



1994



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1994

asses, the 180-day school year and the 3:00 bell,
favor of newer systems that work. What's successful in the Village will become
e norm for the district.

There's a focus on teaching problem solving, especially in math and science,
and on using technology to let kids be the workers in their own education.
ougher and more meaningful testing standards are built in. The schools will
e a laboratory for training teachers within the complex, the entire district and
eyond. The goal: to graduate kids who are ready for the future.

We believe the time has come for Reinventing Education. We're contributing
ot just money and technology, but our experience, ideas and our commitment.
nd we hope that other businesses will also get involved in moving our schools
to the new century. It's in our interest. The better educated our kids are,
e more competitive we'll all be. If you would like more information about
reinventing Education, call us at 1 800 IBM-3333, and ask for *star* 805.

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Breaking the Mold:

The Private Sector's Accelerating Role in Public Education

Some business leaders say that fixing our nation's schools is the hardest, meanest, bloodiest thing they've ever tried to do.

The good news is that after years of exceptional effort – and as much frustration – the private sector is charging ahead, helping clear the way for reform. And various strategies for shaking up the educational system are meeting with some success.

Between the Fourth of July and Labor Day this past summer I drove across our country – some 8,800 miles – through 38 states, visiting with Americans whose lives can help us make sense of the world in which we find ourselves. I stayed in their homes, ate supper with them, and stayed up late talking. The question I most frequently asked: “Looking ahead 20 years, do you think your children will have as many opportunities in America as you have had?”

In Boston, during a conversation with Dr. David Birch, a former M.I.T. professor who tracks the rise and fall of American companies, I thought back to 1981. That was the year when he taught me the single most important lesson I learned as Governor of Tennessee: that 10% of Americans lose their job over the course of a year. In Tennessee, that meant about 220,000 people. Even recruiting Nissan and Saturn to Tennessee would never replace all the jobs we were losing every year.

TURNING HEADLIGHTS ON BRIGHT

We came to see that instead of importing jobs, we had to create a climate in which new jobs would grow. So we set out to improve the entrepreneurial climate – cutting through red tape, keeping the tax rate low, and creating a Business Roundtable to encourage a pro-jobs atmosphere.

But as we quickly discovered, all of that was second to education. We had to provide a steady stream of well-educated workers who could meet the new demands of the Information Age.

I recall visiting the headlight-assembly team at the new Saturn auto plant in Spring Hill. The team knew

it was up against stiff competition from Japanese and German automakers. To produce a defect-free headlight, workers had to write and speak English well, have a good grasp of mathematics and spatial relations, and understand the need for teamwork. Not an easy prescription to fill. These were skills no auto workers had ever been required to bring to a job.

So we launched a crusade to improve our schools. We made sure every Tennessee student was computer literate by the ninth grade, paid teachers more for teaching well, created summer programs for gifted students, and upgraded the quality of our higher education

partly by adding 87 endowed chairs of “excellence” at our universities.

Hardly any of this would have happened without support from the private sector. For many companies it meant shifting from a hands-off to a hands-on role in education.

Business leaders formed Tennesseans for Better Schools and raised \$500,000 to help push a 10-point Better Schools program through the legislature. Corporate executives served on higher education boards and matched state dollars to help fund those 87 chairs. Companies adopted schools, gave awards, and formed partnerships with communities. Our Business Roundtable made education its No.1 priority.

Tennessee's story is worth the telling because it shows how school reform, like all politics, is local. No one knows how to improve schools better than the community itself.

A NEW AGENDA FOR ACTION

Governors in every state were getting the same message. All of us were becoming convinced that in the midst of a world of enormous change, American education seemed to be trudging along in the same old rut.

At that time, I was chairman of the National Governors' Association. We decided to change the education agenda by doing something governors had never done before: devote an entire year working together on a single subject – education. Our strategy to get things off dead center was to ask these questions:

1. Why not pay teachers more for teaching well?
2. What can be done to attract, train, and reward excellent school leaders?
3. Why don't we let parents choose the school their children attend?



Lamar Alexander

en't there ways to help poor children succeed in school?
 Why are expensive buildings closed half the year when children are behind in their studies?
 Why shouldn't schools use the newest technologies for learning?
 How much are college students really learning?

HORSE TRADE TO GET RESULTS

86 the governors answered those questions in a report called "Time for Results." It proposed that we use old-fashioned horse trading: we'll regulate less school districts will produce better results. How? The report laid out a set of radical reforms such as school choice, all-day and all-year schooling, and performance pay for teachers and school leaders.

A few years later President Bush and all fifty governors met in Charlottesville to establish ambitious National Education Goals for the year 2000. Those goals refocused the nation's attention on the need for setting high academic standards, especially in math and science. They also reminded the nation that a child's education starts early – at home.

In 1991 came the America 2000 strategy designed to move the country, community by community, toward those goals. High academic standards, improved student testing, increased federal regulation of teachers, break-the-mold schools, more school choice for parents – these were the building blocks for better schools.

Inviting the private sector to join in was perhaps the next best step of all. An enormous number of organizations and executives, from Wal-Mart to the U. S. Chamber of Commerce, rallied to the cause. Former Xerox CEO Ed Kearn took the lead in helping launch the New American Schools Development Corporation. The corporate leaders who made up the board raised \$100 million to help communities create break-the-mold schools. This was the first time in anyone's memory that educators were setting – and advancing – such a national agenda with leadership and dollars.

STUCK IN THE SAME OLD RUT

Improvements came painfully slow. Most of the news stories told how we had established goals most children did not achieve. Even the combined efforts of governors, executives, and community leaders could not overcome the resistance of entrenched interests. For the most part, the education system was stuck in the same old rut.

Today, about 10 years since the governors' call to action, transforming America's education system is even more important. Of the 100 million workers in the private sector, some 10% still lose their jobs each year. Those jobs must be replaced. The approach we took back in Tennessee – focus on the job spigot instead of the job drain – is still potent. To put it another way, it's the key to our future standard of living.

Almost every business person I met this summer on my cross-country drive knows this. Better schools mean better jobs.

In Detroit I talked with Bronce Henderson, the chief executive of a company that makes robotic systems for assembling automobiles. It's a company my friend Professor Birch likes to call a "gazelle" – one of the 270,000 or so rapidly growing firms with at least 50 employees that create almost all of America's new jobs.

"I can't find enough trained workers,"

Bronce told me. "Working capital, faster approval of environmental regulations, no tax increases – they're all critical factors in keeping my company growing, but nothing is more important than education," adding, "If we're not careful, we're going to wind up with the top two-thirds of America doing very well and the bottom third stuck for lack of a good education and the good jobs you get with it."

'FIND THE GOOD AND PRAISE IT'

Bronce's comment reminded me of the first night of my drive when I stopped in Henning, Tennessee, the hometown of my late friend Alex Haley, the author of *Roots*. I drove by his grandparents' home, and on the gravestone by the porch, where we buried him two years ago, were the six words by which he lived his life, "Find the Good and Praise It."

In that spirit, we should praise the good things communities are doing with their schools. It is a matter of starting all over again – creating a whole new educational framework that fits today's children and tomorrow's world. The challenge may seem awesome – some might say impossible. But I believe it can be done.

Within this huge country there are some 15,000 school districts filled with parents, teachers, and local business leaders working hard to help children learn.

In this *Business Week* special education section we'll describe 10 of the most effective strategies that communities – in close partnership with the private sector – are using to break the mold and create the best schools in the world for all of our children.

*About 10 years
 since the governors'
 call to action,
 transforming
 America's
 education system
 is even more
 important today.*

Putting Reform on a Faster Track

STARTING EARLY

1 Today, in communities across the country, there's a new focus on the importance of taking care of children before they go to school – even before they're born.

Cocaine Kids. In Detroit's Hutzel Hospital, one-third of the 8,000 babies born each year have already been exposed to cocaine through their mothers. When I visited the hospital, clinical nurse Julie Sullens told me, "Some of these children cry all night. They're inconsolable."

This is like planting land mines on our most populated beaches. Some of these babies will never fit into families, into classrooms, into our society. We and they will pay a horrible price.

In a far less extreme situation, Dallas-based Texas Instruments saw the problems facing many pre-school children in its own city. In 1990, along with Head Start of Greater Dallas and other public and private agencies, it created the Margaret Cone Head Start Center. This pre-school program for disadvantaged four-year-olds provides extended day and year-round care – as well as education, health, nutrition, and social services – for children and their parents. Texas Instruments doesn't leave the kids in limbo. Cone children go on to attend kindergarten through third grade at Frazier elementary, a TI School Partner In Education.

Pre-school Partnership. In Rochester, Kodak's 21st Century Learning Challenge created a partnership with the Edison Technical and Vocational High School. Out of this came a new, two-classroom Montessori Pre-school for more than 70 four-year-olds that was built with materials supplied by local businesses. Kodak underwrote and coordinated the project.

SET ACADEMIC STANDARDS HIGH

2 All children can reach high academic standards, but most American parents don't believe it.

"Students can learn mathematics if they have the *ganas*," says Jaime Escalante, a high school math teacher in California, using the Spanish word for desire. "This is the only thing we need from students – the desire



In Dallas the Margaret Cone Head Start Center, supported by Texas Instruments, provides extensive day care all year long for pre-school children

to learn." And Escalante's amazing career as a teacher proves it. In the 12 years he's taught calculus at Garfield High School, 576 of his students have done well enough on the Advanced Placement test to receive college credit.

"Students should be able to think through problems more effectively," as Charlotte K. Frank, vice-president of McGraw-Hill School Publishing Company, puts it. "And more can learn to communicate better."

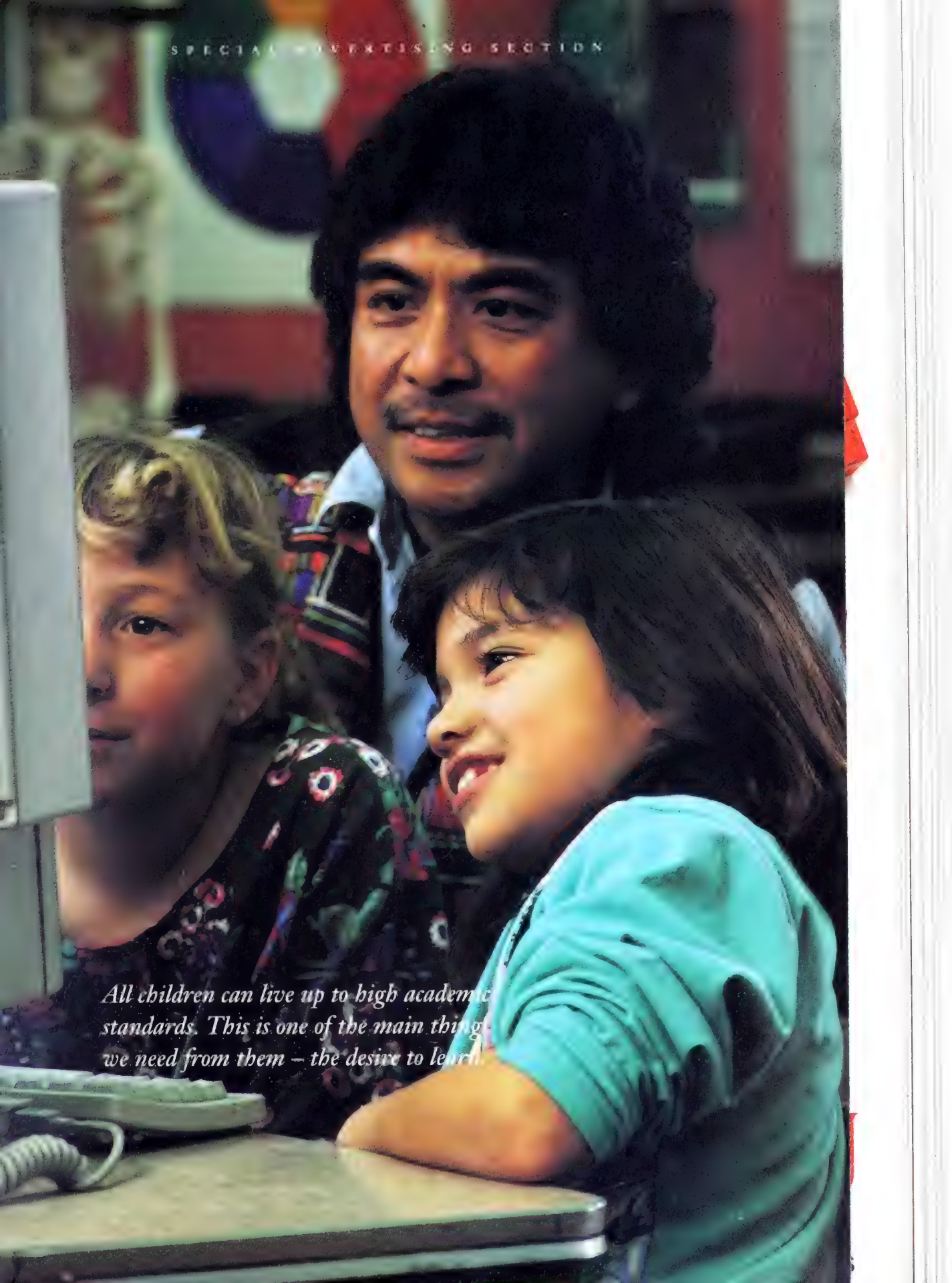
Yet some segments of the American population aren't fazed one bit by tough standards – among them, most Asian families. Their children often attain above-average scores because parents respect those standards and believe they're attainable. There's the Laotian girl, for example

who won a Chattanooga spelling bee only three years after she moved to this country – with no command of English.

Math is one subject where the nation has really raised standards without the imposition of any federal rules. The campaign to improve math instruction began back in the eighties when Iris Carl, a Houston math teacher and president of the National Council of Teachers of Mathematics, led an effort to establish world-class standards for what all children should know and be able to accomplish.

Since the council published its standards in 1989, publishers have been revising their textbooks, states have been changing their math tests, and teachers have gone through retraining programs. The revision has upgraded math instruction in some 40% of the nation's classrooms, according to Carl.

Math is one discipline where the nation has really raised standards without the imposition of any federal rules.



All children can live up to high academic standards. This is one of the main things we need from them – the desire to learn.

FOR OVER 25 YEARS,
WE'VE BEEN APPLYING
OUR INDUSTRY
TO YOURS.

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If our name

is foreign to you, maybe it's because we're building a reputation in America on the reputations we've helped build for others.

Together with Sun Microsystems, we developed the RISC chip that brought mainframe power to desktop computing. And helped make Sun the leading workstation manufacturer worldwide. With U.S. regional Bell operating companies, we're revolutionizing commercial service by creating the world's first switch-system capable of handling voice, data and video over the public network. We've built R&D and manufacturing facilities from California to Connecticut. Building on our reputation as the world's second largest computer company. And creating advances from the smallest and lightest portable pen computers to some of the world's fastest supercomputers. We're celebrating over 25 years well-spent. Not so much on publicity as on products that create possibilities for the next 25 years. So if you're looking for our name in the future, just look behind some of the biggest names in America.


FUJITSU

COMPUTERS, COMMUNICATIONS, MICROELECTRONICS



Yolanda Gamez (left) gives Eric Sanchez (right) a spelling lesson in preparation for an upcoming test. She is one of 25 Coca-Cola Valued Youth tutors from Karen Middle School located in San Antonio, Texas, which was the first site for the Coca-Cola Valued Youth Program.

The improvements have come about none too soon. Says Martin Marietta, one of the country's largest defense contractors, sounding a note of alarm, "Over 50% of all high school students take no mathematics or science after tenth grade, according to one M.I.T. study, and only 1% of American high school students study calculus, compared to 12% of Japanese high school students."

Corporate Catalyst. If there are skeptics who doubt whether children can achieve higher standards, businesses nationwide are doing their best to change their minds. For instance:

■ NationsBank is giving \$2 million to the Southern Regional Educational Board – a consortium of 15 states from Maryland to Florida to Texas – to support the board's program to raise academic achievement.

About one hundred Citibank "faculty" trained at the Coalition of Essential Schools at Brown University are, in turn, training dozens of teachers in new methods aimed at raising children's achievement standards.

Role Models. Through its Valued Youth Program,

Coca-Cola is using tutoring and mentoring as a tool to teach elementary students who require special assistance.

"The concept is to help middle-school students in academic trouble because of family, police, or other factors," says a Coca Cola Company spokesperson. "We're looking at cases where teachers and parents have tried everything. We want to help them turn their lives around by helping them perform a service for younger children."

"One thing that seems to work," she goes on to say, "is making the kids responsible. The Coca-Cola program takes largely Hispanic students at risk of dropping out and makes them tutors to help others who are struggling – and close to failing. They become role models. But to do that, they have to clean up their act. They have to value themselves, as the program's name says."

The program, which works through school districts and community agencies, comes out of the belief that children can actively contribute to each other's education. In Brownsville, Texas – for example – the program matches up students like Juan, 14, and Maria, 13, with

kindergarten, first-grade, and second-grade kids need help with reading and math. The teenagers receive weekly training and get paid for their tutoring. Coca-Cola's program has had a dramatic impact on attitudes, providing a motivation that had been lacking. "The dropout rate among tutors is less than 2% compared to 12% for students not in the program," says Hector Cuca Robledo Montecel. "The tutors believe they have a real contribution to make."

REWARDING GOOD TEACHERS

Tennessee's state-wide program to pay teachers more for teaching well is now 10 years old. More than 7,000 teachers participate in the peer review program. Unfortunately, no other state rewards good teachers with better pay, despite the obvious motivational benefits. Much of the opposition comes from unions. But there's plenty of foot-dragging at many colleges, which perpetuates the completely illogical assertion that there's no way to tell a good teacher from a bad one. As long as that absurd assumption holds, there will be no way to make teaching a truly professional career.

Schools and communities cannot afford to pay all teachers what the best teachers deserve – and they shouldn't. They should and would pay much more if there were a way to select outstanding teachers.

Evaluation Gridlock. The stumbling block in rewarding top teachers has always been the method of evaluation. It may be obvious that some teachers are better than others, but it's not easy to make the distinction fairly. Any system that rewards teachers inevitably produces the kind of work environment nobody wants.

The National Board for Professional Teaching Standards, though moving at snail-like speed, offers some real promise. Established in 1987 to help teaching become a true profession – with the increased pay and responsibility associated with professionalism – it has established rigorous standards that states can use to determine what teachers in every field should know and be able to do. It has also set out to build a voluntary system to assess and certify teachers who meet these standards.

Some two-dozen corporations, from American Express and BellSouth to IBM, The New York Times, and Union Carbide, have supported the board's work.

After completing tests involving some 539 teachers, the board will launch National Board Certification across the nation next year. Eventually, many school districts will pay more to board-certified teachers.

"A lot of teacher training is out of date with what we need today," says Pat Willis, president and executive director of the BellSouth Foundation, which concentrates on promoting education reform in the nine states where its parent supplies phone service. "They don't all get quality training. We've been a big player in new approaches to professional development for teachers – how they're prepared, what kind of annual and regular support they get, and how you expand their knowledge base."

Teacher Recognition. That's not all the private sector is doing to bring the teaching profession up to speed.

■ Upjohn, for instance, selects 12 Michigan teachers each year for its week-long ScienceGrasp program aimed at enhancing the hands-on teaching skills of elementary teachers.

■ The Encyclopedia Britannica sponsors the prestigious "teacher of the year" awards, one for every state and one for the whole country.



BellSouth Chairman John L. Clendenin visits an interactive learning classroom. BellSouth has been involved in educational efforts throughout the Southeast, including interactive distance-learning programs.

■ Some 8,500 teachers now belong to the Geography Alliances that the National Geographic Society has been creating in every state since 1985.

■ Martin Marietta sponsors the Academy for Teachers of Science and Mathematics, a four-week program held every summer on the campus of the University of Tennessee. And it's supporting similar academies in Florida, Maryland, and New Mexico. Through an innovative curriculum,

"They might get
But we'll be running



Robots are useful. Human beings, however, are indispensable. That's why, after years of intensive training, Dave Klenk moved from a job on the assembly line to a job programming and repairing robots. And now, Dave is teaching the skills he's learned to Tim Pruyt. General Motors

robots to do some jobs.

the robots."



General Motors

ing the way it builds cars, and it's helping the people who work there change with it. After all, es just do what they're made to do and no more. Machines can't have a flash of inspiration, a better way. Machines can't take pride in their work. General Motors workers can and do.

teachers "discover the true origins of science and math and the fun and excitement that hands-on activities can bring to the business of learning." The avowed aim: to pass along some of that excitement to students faced with decisions as to what educational courses they should take.

"Students make critical decisions early in their lives, even when they're in elementary school," says Mike Hopp, director of management and organization development at Martin Marietta. "Certainly in junior high a student has to decide whether to pursue – or not pursue – advanced algebra. If you miss it then, you don't ever get to be an engineer."

PUT COMPUTERS IN CLASSROOMS

4 One hundred years after the invention of the telephone, most teachers don't have easy access to one. In classroom after classroom, they look as though they're trying to compete in the Indy 500 with a Model T. As for desktop computers for the kids, the situation isn't much better.

But – thanks to the private sector – change is coming fast. In a showcase program in Portland, Maine, Blue Cross/Blue Shield sponsors a Center for Youth Apprenticeships, which is definitely getting somewhere.

"When children come here from their high school classroom," says Jean Mattimore, the center's executive director, "it's like going from one age into another.

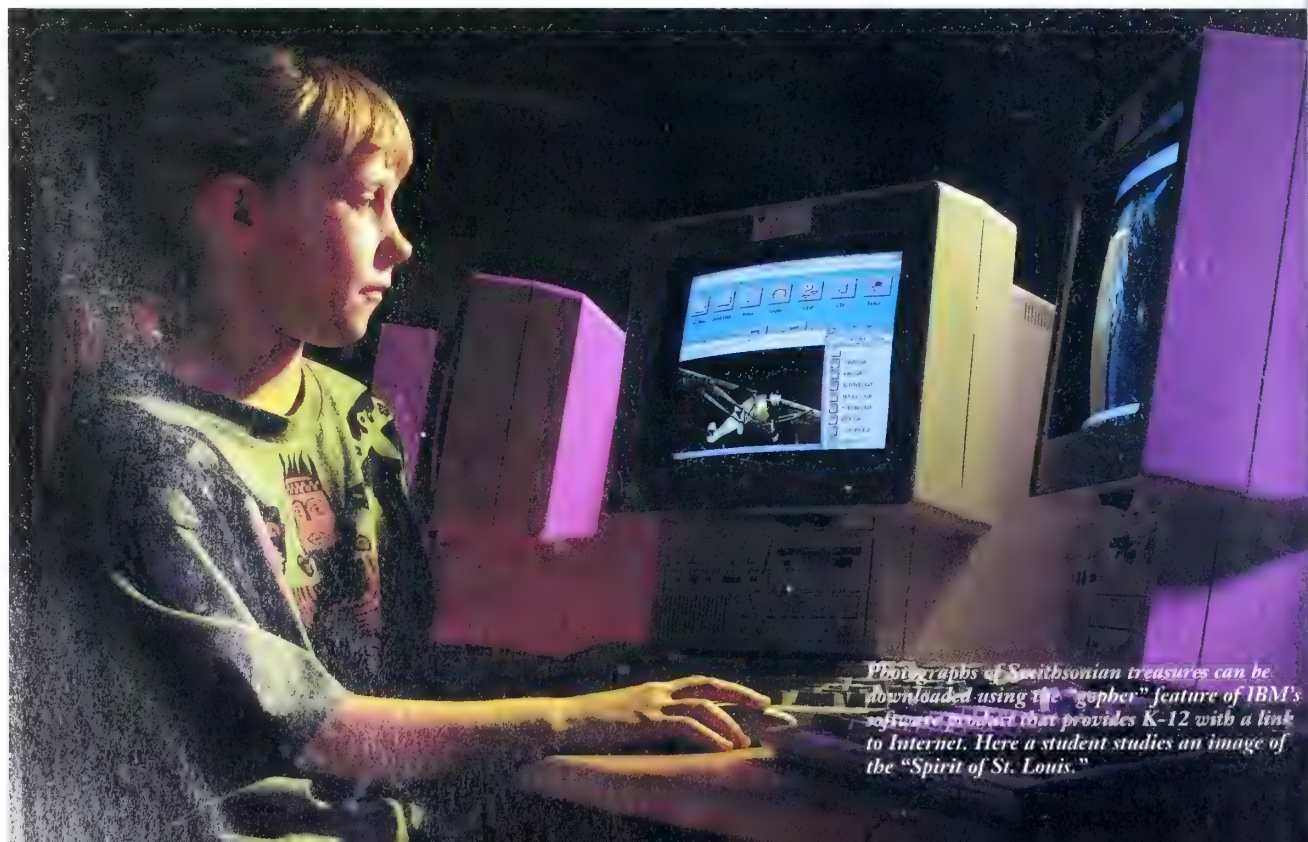
There are really no manual-labor jobs here. Nothing they see in school looks like what they'll find to work with here."

Classroom Computers. Coast to coast, companies are putting computers and other high-tech equipment into classrooms.

■ In Houston there's a new K-8 school with one PC for every four students – the product of a partnership between the Houston Independent School District and one of the city's biggest companies, Compaq Computer. The school integrates core subject areas like math and science in a challenging academic program. Compaq provides not only computers but also video disks, CD-ROMs, on-line access to data bases, and technical support. The company even goes so far as to help recruit talented faculty from around the nation.

■ In two states IBM is upgrading teaching with computer technology. Its New York State Initiative is a pilot program to determine how a statewide educational network might work in all New York public schools. And in the South the IBM Mississippi 2000 project provides computer technology, educational software, and a fiber-optic audio and video system to link teachers and students in rural classrooms across the state.

■ This year Apple Computer's program called "Partners in Education Grants" will provide 11 K-12 schools and 11 teacher-training institutions with \$1.2 million worth



Photographs of Smithsonian treasures can be downloaded using the "gopher" feature of IBM's software product that provides K-12 with a link to Internet. Here a student studies an image of the "Spirit of St. Louis."

ITT TECH STUDENTS PASS THEIR BIGGEST TEST AFTER GRADUATION.

UNIT TEST SUPERVISOR
Individual will supervise 10 to 15 electronic technicians in a test laboratory. Responsibilities include oversight of two million dollars worth of test equipment and inventory. An excellent knowledge of electronics is required. A Bachelor's degree in electronics engineering is a prerequisite.

PRODUCTION FOREMAN
Supervise a large electro-mechanical assembly process and electronics repair department. You must be capable of reading electronic schematics, operate a personal computer, implement inventory control systems and schedule work shifts. Position is also responsible for safety and on-the-job training of new employees. Administration of department budget and part/row charts are part of the normal daily duties. A Bachelor's degree in electronics engineering technology or automotive manufacturing required.

UNIT TEST TECHNICIAN
An excellent career opportunity exists for the individual who has excellent electronics troubleshooting skills using the latest test scopes and digital counters. You will work at the black box level on work of the airborne infra-red systems. The ideal candidate will be able to work at the systems level and be responsible for repair and quality control of own work. Security clearance and physical required. An associate degree in electronics technology is required.

AVIONICS TECHNICIAN
Maintain and repair aircraft electronic systems including: airborne radar, navigation equipment and communication systems. Position requires a versatile technician with an associate degree or higher in electronics technology. Some on-board flight tests may be required. Must pass a pre-employment drug test and security check.

CONSUMER REPAIR TECHNICIAN
Entry level position for a person with an associate degree in electronics technology. Must have a sound understanding of electronics, lab test equipment and good hand/eye coordination. Requires a clean drivers record. The selected individual must present a mature image to our customers.

COMPUTER-AIDED DRAFTER
Requires a thorough knowledge of conventional drafting along with use of computer-aided technology. A diploma of 1440 contact hours or an associate degree is required. Will work in support of both electronic and mechanical engineering areas.

COMPUTER-AIDED DRAFTER
Light industrial company needs a computer-aided design area support in maintenance, architectural and new construction. Must have formal training of 1440 contact hours or an associate degree.

AUTOMATED MANUFACTURING TECHNOLOGY
Robotic technician to support large front-end micro chip clean room area. Prefer assembly or Pascal language knowledge. Will interface with manufacturing manager. Requires a Bachelor of Applied Science degree with a thorough working knowledge of electronics.

AUTOMATED MANUFACTURING TECHNOLOGY
Technicians to support robotics in large front-end micro chip clean room area. Assembly or Pascal language knowledge preferred. Requires a Bachelor of Applied Science degree with a thorough working knowledge of drafting and CAD technology.

UNIT TEST/ACCEPTANCE TEST TECHNICIAN
Associate degree in Electronics Engineering Technology. Must be current in electronics and able to troubleshoot to component level using scopes, signal generator, VOM and digital analyzers. A variety experience and clearance.

SYSTEM ENVIRONMENT TEST TECH
Associate degree in Electronics Engineering Technology. Must be able to operate at a system level. Must be able to oral instruct to technical.

CUSTOM SERVICE
Requires excellent technical skills and must have a good communication ability.

ing a job with a future, one that is related to their education, that's the ultimate test college graduates face. A good education isn't enough. Students need both theory and the practical application of the theory. It's necessary in an increasingly specialized job market. At ITT, we had a vision for a system of higher education that prepares students to meet the demands of American businesses. Taught by instructors with real-world experience. So graduates will be better prepared

to handle the jobs tomorrow's technological workplace will produce.

That's what led us to invest over \$60 million in ITT Technical Institutes. ITT Tech is one of the leading private career-focused programs in the U.S. Teaching entry level skills for productive jobs in telecommunications, consumer electronics, aerospace, computer drafting and other 21st century fields. It's good to know our investment is working

ITT

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No breaking in needed thanks to our padded collar and full leather lining

Shock absorbing footbed takes the punishment - not you

Arch stabilizer supports you every step of the way - all day long

Millions of air bubbles means you're walking on air

Soft, supple leather uppers give you all around comfort



Comfortech

TAKE THE

CHALLENGE...

and slip into a pair of shoes that feels as cozy as your favorite easy chair. Whether you spend a lot of time on your feet or just want to discover the most comfortable shoes you've ever worn - take the Florsheim Comfortech Challenge.

HEIM



Special heel lets you
take the pavement
in stride

Variable tread for
sure-grip traction
wet or dry

Lightweight,
long-wearing, flexible
outsole lasts five times
longer than leather soles

out for yourself just how comfortable a pair of shoes can be and why Florsheim Comfortech shoes are
mmended by Podiatrists nationwide. For the
shheim dealer nearest you, call 1-800-446-3500.

FLORSHEIM

Florsheim Comfortech styles start at \$69.95.

of equipment to help them prepare both students and teachers for the twenty-first century. Apple will also conduct an 11-day retreat at the Walker Creek Ranch in Marin County, just north of San Francisco, to help train those who've received the computers and peripheral equipment.

Many communities are using technology to go beyond what happens in school and increase communications between school and home. In Montgomery County, Maryland, several schools are using voice mailboxes for teachers so that parents can call to get their child's homework assignment. One of those schools received more than 750 calls the first week.

Many of the calls came from students who like the technology. It helps make school fun!

Technology is not just a new set of toys. It's a new way of thinking – a new way of living. Not feeling comfortable with today's technology can be a major obstacle to helping a child make the transition from school to a good job.

MAKING SCHOOLS SAFE

5 The streets around many schools are so dangerous that adults are fearful. It is shocking when a 12-year-old boy is under indictment for murder, but that was the case recently at a middle school I visited in East Los Angeles. Even in "nice" neighborhoods, school safety is a problem. In Rockdale County, Georgia – for instance – a shooting at Heritage High School led the community to institute a virtual ban on weapons.

All parents want good and safe schools for their children. Every school should have a zero-tolerance weapons policy. And every community should have alternative schools so that troublemakers can be sent to a tightly disciplined school rather than out on the streets.

The private sector is helping here, too. In Kansas City, Missouri – for example – the top executive of Marion Merrell Dow, a pharmaceutical company, set up the Kaufman Foundation to run Project Star, which teaches students how to resist the social pressures to smoke, drink, or take drugs.



At Informart in Dallas the EDS Information Technology Pavilion gives kids an inside look at how automation works in manufacturing plants.

KEEP SCHOOLS OPEN LONGER

6 Schools are supposed to fit the needs of families. Yet even though most women now work outside the home and many parents are single, nearly all schools still continue to operate from only 8 a.m. to 3 p.m. and stay open only half the days of the year. It's a maddening situation. A school that's open for so short a time fits very few family schedules.

I have yet to be in a school that was not safer than the neighborhood surrounding it. In the Bronx, for example, I visited a school where students – mostly Colombian-Americans – were getting a good education. Yet the school hardly looked like a place for learning. It had fences topped by the kind of razor wire we use in prisons because of the bad neighborhood. At 3p.m. the bell would ring, the doors would open, and the school would close, emptying the children into the streets that offered little but trouble.

More Than Day Care. There is absolutely no excuse for any school to close so early and turn children out unattended. Nearly 10 years ago, in Murfreesboro, Tennessee, the school system asked Becci Bookner, a kindergarten teacher, to start a pilot program of academic activities that would appeal to families both before and after school. It began with 21 kids and now has 2,200 – half of Murfreesboro's student body. School buildings are in use 12 hours a day year-round.

It's not day care in disguise. "Children in our program have access to computer labs, foreign language classes,

Through an innovative curriculum, teachers "discover the true origins of science and math and the fun and excitement that hands-on activities can bring to the business of learning."

lessons, sports – even homework classes,” says the teacher. “Parents can choose the hours their children attend school. Our program supports families and promotes education.”

Most of this is done at no extra cost to Murfreesboro’s residents. Families pay up to \$26 a week – with special arrangements for those with financial problems. And now over 1 federal dollars are also available for schools participating in such programs.

It is time to face the obvious,” states *Prisoners of Time*, a report recently published by the National Commission on Education and Learning. “In many communities, when children are not with their families, the next best place for them is the school.”

SCHOOL-TO-WORK BRIDGE

For many students, making the transition from school to a job is like stepping from the Industrial Age into the Information Age. It’s a wrenching change. What they’ve learned at school doesn’t fit what they need to know at work. Much of it is designed to prepare students for college. That’s why so many juniors and seniors who aren’t going on to college are bored with what their high schools are offering them. Several states have worked with their business communities to develop youth apprenticeship programs. Tennessee, for example, created a three-year program – spanning the tenth and eleventh grades and the first year of a technical college – in which participants spend

about equal time learning and working. Supervising each apprentice is a representative from a local company or business.

During the three years, employers pay the apprentice an annual fee of up to \$5,000. If a business decides that a graduate’s performance falls short of the skills described on his or her technical-college certificate, the program will pay for the apprentice to return to school.

Hands-on Training. In 1992 Siemens, the German electrical and electronics-products company, set up three pilot apprenticeship programs in the U. S. They combined academic learning with paid hands-on training on the factory floor – all supervised by a “Meister.”

The programs have been so successful that Siemens is launching 11 more. Typically, applicants for the 20 yearly openings at the company’s Stromberg-Carlson installation in Lake Mary, Florida, must have completed high school courses in algebra and English composition. Once enrolled in the program, apprentices have to maintain a 3.0 grade point average in a curriculum that includes calculus and physics. Those who stay in the course get amply rewarded – with jobs that initially pay \$27,000 a year.

Upgrading Utica. “Our success as a high-tech company is directly tied to the ability of our schools to produce students of world-class talent,” says Larry Stone, public affairs manager at Martin Marietta’s Ocean, Radar & Sensor Systems facility in Utica, New York. “In recent years we’ve teamed with the Oneida County School and

Business Alliance to help students make a successful transition from school to work.”

In a three-pronged program, Martin Marietta tries to “broaden the life and work experiences of work-bound students to make them more employable.” Here’s how:

■ **Mentors.** The company helps put “at-risk” high school students on a new and better track by teaming them with Martin Marietta mentors.

■ **Summer Jobs.** Each year about two dozen students from Oneida high schools take part in a summer-jobs program, funded by Martin Marietta, that gives kids meaningful work assignments in disciplines matched to their career interests. The program, now beginning its fifth year, has produced many success stories.

■ **Teacher Training.** After developing a 20-hour course in communication and problem-solving that its own employees found quite useful, the company turned around and offered it to about a dozen



General Motors works closely with communities where it has plants and trains young people to jobs that require considerable skill.



For years, Sandy Fitch taught business education using textbooks and standardized tests. Yet for years, she also felt there had to be another way.



On the Mac, Sandy teaches her students Microsoft Excel and Aldus PageMaker, as well as many other programs widely used in business today.

One that her students would find more relevant, more involving, more motivating. Sandy admits even she was bored with her old teaching methods. More important, she was concerned that her students weren't

as well as their ability to follow directions and write — all critical workplace skills. "What a difference!" Sandy says. "Their work — and their evaluations — improved dramatically. They really got into the project because it had meaning for them, unlike my earlier methods of teaching and testing. The Mac gave them a chance to be more innovative." Now, Sandy proudly declares, her students have the skills for an entry-level job anywhere in the country. "They are computer literate and have strong enough communica-

Sandy Fitch created the most successful school-to-work program at Yarmouth High. But she didn't do it by the book.

getting the hands-on training they'd need to compete in the workplace. So, in the spring of 1992, Sandy decided to try a different approach: Macintosh® personal computers. With this new teaching tool, Sandy developed a three-month-long project in which each student was asked to complete 11 business-related activities — all on the Mac.™ Her students started in with enthusiasm. They wrote résumés. They assembled databases of employees and salaries. They produced a company newsletter. They even created a profit/loss statement. After they were done, the students were evaluated on their innovation and creativity,

tion skills so they'll feel comfortable in the workplace." Plus, with the multiple operating systems capabilities of Apple's



Using a laser printer, Sandy's students are able to create professional-looking documents — complete with charts, graphics, clip art and sharp, crisp text.

new Power Macintosh™, proficiency on the Mac prepares students for practically any office computer environment. All of which brings a new power to education. The power that makes learning more engaging and more effective in training students for the workplace. It's the most important power any teacher can have. The power to be your best.®



school administrators. They liked it so much that some are now giving the course to their school staffs.

Smoother Transitions. There are many types of school-to-work transition programs, but few are as extensive as those backed by ITT's 48 Technical Institutes. The company's educational network offers college-level programs of study to approximately 20,000 students in twenty-four states.

Last January, for example, ITT Tech and the Hamilton high school Complex in Los Angeles began offering electronics engineering and computer-aided drafting programs that enable a student to complete an academic quarter of college-level work while still in high school.

CONNECTING WITH COMMUNITIES

8 "It takes an entire village to educate a child" is an African proverb that has become a favorite motto of almost anyone who spends much time trying to reform education. The school's educational responsibilities really come third – after family and neighborhood – and too often today both are falling down on the job.

It was with this in mind that nearly 140 private-sector companies and organizations formed the America 2000 Coalition to support community efforts to reach our National Education Goals.

This fall the coalition is launching Goal Line, an on-line computer service that lets education reformers from all across the country talk to each other, share ideas, ask questions, and get help.

Breaking the Ice. Community-wide efforts usually start the way one did in the Lehigh Valley of Pennsylvania when business leaders, unhappy with the quality of the area's schools, met with education leaders. "It was freezing cold outside, but it was even colder inside," says Ed Donley, then chairman of Air Products and Chemicals, recalling the chill at the first meetings.

Once the finger-pointing stopped, the two sides established Lehigh Valley 2000: A Business Education Partnership. It set common goals, developed strategies for achieving those goals, and found ways to measure progress. Everyone got involved – parents, teachers, political leaders, civic organizations, even the media.

In Omaha, John Gottschalk, publisher of the *Omaha World-*



It's story-telling time with Celso Frazao, a volunteer from Tandem, who participates in this interactive session.

Herald joined forces with the local chamber of commerce in a similar effort called Omaha 2000. From time to time the newspaper publishes a report card on the program's progress. All in all, the 2000 campaign has made a big breakthrough in expanding community involvement in the city's schools.

Working World. All of the Big Three automakers – General Motors, Ford, and Chrysler – are helping give educational reform a boost.

"Our involvement in education began about 10 years ago when we started thinking about the 21st century coming up," recalls Valerie Becker, who's in charge of Chrysler's national education program. "People were thinking, my goodness, the world is changing – but schools aren't changing with it. Technology is passing them by. There were children coming to school more technically adept at computers – and technology – than their teachers."

Now a leader in corporate commitment to better education, with programs ranging from "Reading Together" to a partnership in the annual PTA survey of parental involvement, Chrysler even has a "Build Your Dream"

contest at auto shows – "an artsy thing where you design your dream car," as Becker puts it.

One of the company's most ambitious programs is "World of Work," which encourages employees to share their expertise in a school of their choice in the dozens of cities where the automaker has plants and dealerships. "If you want to teach chess, math, or almost any other subject, you simply volunteer for one hour a week – and Chrysler gives you the time off," says Becker.



Kid Witness News, the hands-on video education program, is sponsored by Matsushita Electric Corporation of America.

other Chrysler initiative: conducting seminars for employees interested in running for their local school boards.

Knowledgeable Workers. Through its "Pre-College Port Strategy," General Motors has developed a two-channel of communications with the communities where it has plants. The No.1 automaker helps fund local programs, encourages GM volunteers to work in classrooms, supports performance measurement, and emphasizes improvements in reading, writing, mathematics, and science. In the process, GM learns a lot about its customers and community needs. Right now, the company's particular pride is its program called "GM Skilled Trades Engineering: Explore the possibilities." Middle-school students, especially young men, minorities, and their parents, get a better idea of career opportunities and gain the confidence to pursue them. Among the program's goals: equip students so they can solve application-based problems requiring higher-order thinking skills. "So far, the program has been very popular with the more than 10,000 students in seven states, both urban and rural districts who have participated in it. The team developing the final Science Standards for American Education is drawing on the materials used in "Explore the possibilities."

Productive Adults. In one corner of the U.S. — Maine — is plenty of corporate action supporting educational reform.

UNUM, the nation's leading provider of disability insurance headquartered in Portland, Maine, is putting its shoulder behind the work of the Maine Coalition for Excellence in Education, a grassroots community-based organization that brings together leading educators, public officials, and businesspeople. James F. Orr, III, UNUM's president and CEO, in fact has served as chair.

"We're involved because we need an educated workforce to keep us competitive in the coming century," says John Healey, director of UNUM's Corporate Public Policy Department. "As America shifts from a manufacturing

to a service and information economy, innovative and knowledgeable workers will become increasingly important," adding, "They need to be able to process information, make informed decisions, and understand the effects of those decisions. Many workers, willing as they are, are having trouble doing this. They're not adequately prepared."

In line with this, the Maine Coalition recently recommended that public education should move toward a focus on results. "The whole idea," says



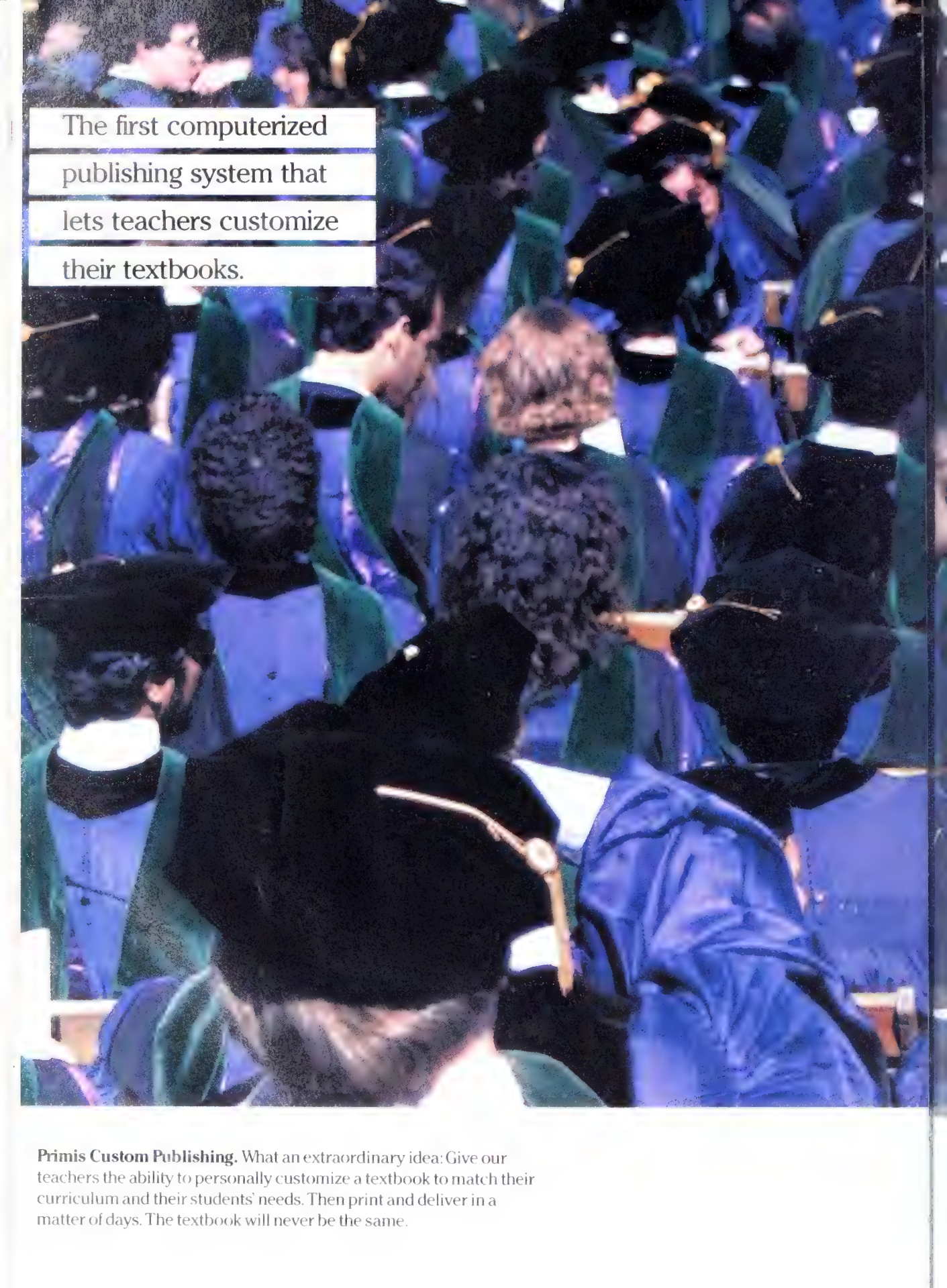
Through its 'Partners in Education Grants' program, Apple Computer supplies equipment that helps students get advanced training in computers and science.

Tracy Sherman, UNUM's manager of public relations, "is to teach kids what they need to know to be successful, productive adults."

START FROM SCRATCH

9 You've heard a building contractor tell you, "It'll be cheaper and quicker to tear it down and start over than to remodel." You don't really believe it, but eventually, when you receive the bill, you do.

It's pretty much the same thing in school reform. "There are many more schools performing better than people believe," McGraw-Hill's Charlotte Frank says,



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despite all reform efforts, there are some that aren't. And any that aren't aren't working well, and have not been serving communities for years and years and – I'd say goodbye to the present design, because it's unfair to kids.

One of the pioneers of the "break the mold" approach is the Next Century Learning Program started by IBM Chairman and CEO Louis V. Gerstner, Jr. when he was head of RJR Nabisco. (He recently came out with an incisive book on reform, *Shaping Education: Entrepreneurship in America's Public Schools*.) The foundation committed \$30 million in grants to 43 schools across the country to help improve academic performance of their students. The results include the Downtown School

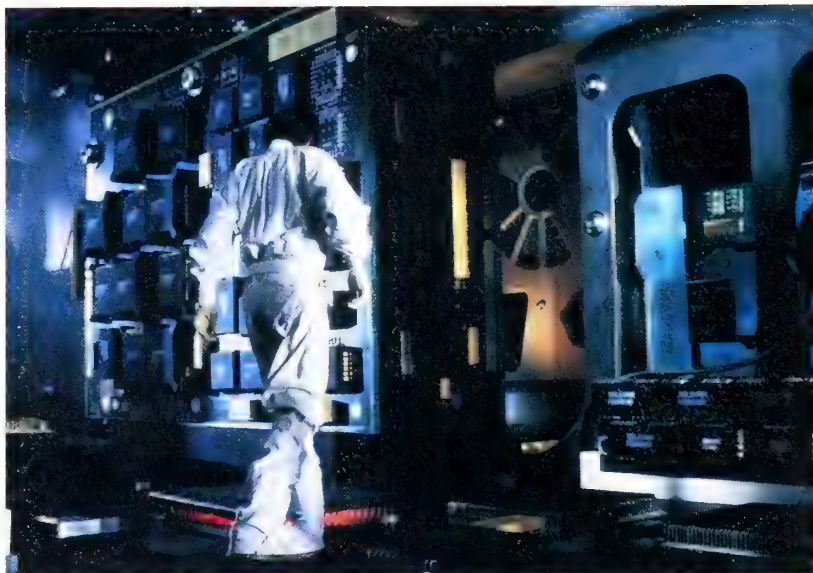
located near the parents' place of work in Winston-Salem, North Carolina, and the New Stanley Elementary in Overland Park, Kansas, where students keep the same teacher much longer than they do in the average public school.

High-performance Schools. At the New American Schools Development Corporation, a private non-profit organization formed in 1991, the idea was to create turn-the-mold schools. Start from scratch. Completely rethink our concept of schools. Design new, high-performance schools that would be the best in the world, uniquely American and unique to each community. From proposals submitted from every part of the nation, 10 design teams were chosen.

Today, those teams are working on blueprints for over 130 public schools in 19 states from Maine to California. Next year New American Schools will begin helping communities adapt the designs in a nationwide roll-out.

One of the design teams, called Co-NECT, will provide every student with a laptop computer. It can be used for projects, explore databases and on-line libraries, swap ideas and information with scientists, professors and students.

Old and New. In a departure from traditional education, Hudson Institute is blending old and new in the educational structure of its Modern Red Schoolhouses in the Bronx, Indianapolis, and Beech Grove, Indiana. Each school is requiring all students to master a core academic curriculum of math, science, English, history, and geography – a very classic approach. But classes mix together students of different ages, teacher/advisors stick to a class rather than change almost every year, and classrooms come equipped with computers and other modern technology.



Intel's *'The Journey Inside: A Learning Adventure in High Technology'* blends education and entertainment to excite and inform youngsters about the science behind computer technology.

In yet another experiment, the Community Learning Centers of Minnesota are helping teachers and other education professionals create charter schools. Operating outside the current education system under an agreement with a local board, they have nearly total autonomy in decision-making in exchange for the promise to produce academic results.

PRIVATE MANAGERS FOR PUBLIC SCHOOLS

10 One of the most volatile issues on the nation's educational agenda is the private management of public schools. The concept seems to be catching on. In today's world, when people are questioning what government bureaucracies can accomplish, inviting private companies to manage public schools and many of the district services makes a lot of sense. It's hardly a radical solution. In fact, it's right in line with the trend we see everywhere.

Take the case of Baltimore where a courageous superintendent, Walter Amprey, backed by his mayor and school board, hired Education Alternatives, Inc., to help manage 12 inner-city public schools. You could see results within the first 30 days. Schools that had been urine-stained were spic and span – a fast start in a long process of improvement.

Since then, Amprey and Education Alternatives, working hand in hand, have put two teachers and a telephone in every classroom and new computers in every school (four in each class and one computer lab), along with drawing up a personal education plan for every child. All of this, says Amprey, for no more money than the other public schools in Baltimore are spending. In another Baltimore experiment, Berlitz is teaching students foreign languages.

COURTESY OF INTEL

Other cities are opening the door to private management of their schools.

- In Miami, Education Alternatives is running South Pointe elementary school.
- Hartford is considering having the company manage all of its schools.
- Minneapolis has hired Public Strategies Group to supervise its entire district.
- Washington, D. C. is using Sylvan Learning, Inc. to help teach reading.

Undoubtedly the most publicized experiment in private management of schools is the Edison Project, launched by entrepreneur Christopher Whittle. It began its work of designing a new type of school almost as though it were a company creating a new product. It started from scratch by asking the question of schools that management-consultant Peter Drucker likes to put to businesses: "If you weren't already doing it, would you start?"

Out of this fresh thinking, Edison has developed an extraordinary blueprint for schools and is now working with dozens of school districts to make it a reality.

Strategies for the Coming Century

Hardly anyone would disagree that America's schools need to be transformed. They're simply out of touch with many of our needs. But beyond the 10 recommendations already described, what are the two most promising strategies that especially deserve support?

CHARTER SCHOOLS: A DECLARATION OF INDEPENDENCE

Of all the proposals that have surfaced over the past ten years for actually changing schools, the charter school – or independent public school – is surely one of the best. Eleven states have now passed charter school laws. Many more are considering legislation.

What does "charter" really mean? It means starting from scratch. Design your own school to fit your children's needs. Unleash the wisdom and creativity of parents, teachers, school leaders, and the business community. Free them from rules and regulations and let them have at it.

Charter schools are the opposite of the one-size-fits-all approach. The idea is that as long as a school is



McDonald's franchisees have established education programs to help kids and their parents.

safe, the children are learning. And if the parents choose the schools, they will support them. Monitor them. But keep hands off.

In a sense, charter schools are a public-school version of private independent schools. These "independent public schools" have the autonomy that may well be – according to almost every public school principal and teacher – the greatest advantage of private independent schools.

In the effort to create charter schools, business leaders nationwide can help by applying lessons they've learned while restructuring their own companies.

In any case, the charter movement clearly has a grip on Americans dissatisfied with the traditional order of education, as these examples show:

■ **Minnesota.** In 1992 it passed the nation's first charter-school law. It now has seven schools operating, four approved and ready to open, and nine others permitted under the law. Perhaps the most innovative is Metro Deaf, which serves hearing-impaired students and their families.

■ **California.** The state that's so often on the leading edge of national trends has given charter numbers – the first step in the recognition process – to over sixty of the hundred allowed under its law. By year-end, almost all should be open and operating.

■ **Massachusetts.** In the nation's early days, Massachusetts helped create the common

school, and now it's doing it again – with charter schools. It has approved 15 of its legal limit of 25 charters, with five serving at-risk and disadvantaged youth. Three are schools to be managed by the Edison Project. And among the state's approved charters is a boarding

For many students, making the transition from school to a job is like stepping from the Industrial Age into the Information Age. It's a wrenching change.

for homeless children headed by a retired admiral. Picking up on the charter concept, Michigan paved the way for state universities and school districts to create "public school academies." University of Michigan operated by Wayne State University is entering its second year. And seven other public school academies are opening this fall – among them, the new Chippewa Academy in Mt. Pleasant and the School Educational Child Care Center in Lansing. The charter-type school that's making the most headlines in Michigan is the Noah Webster Academy, headquartered in a log cabin in a small rural district between Lansing and Grand Rapids. It's a computerized study network, which some 1,500 children in the district want to join (through their parents). Equipped with a modem, you choose your curriculum from the academy's menu, and Noah Webster supplies the on-line and follow-up support. Whatever the charter experiments turn out to be – fairly conventional to radical – the common denominator is the goal of creating new schools from the ground up.

SCHOOL CHOICE: A BILL FOR KIDS

One of the most promising strategies for improving children's education is to give all families, especially poor ones, more choices of schools – public, private or religious.

It is incomprehensible that so many Americans are unwilling to give children the best path to success in America – the opportunity to attend the school that their parents believe best suits their needs.

School choice is perhaps the most controversial issue in education today. The parents and most public school leaders are set against it. While some who favor school choice are convinced that competition will make schools better, opponents claim it will destroy public schools.

Both sides are missing the point. Diane Ravitch got it right when she recently said, "No child's children should be compelled to attend a bad public school."

It's a matter of fairness. If parents don't have the money to move to a better neighborhood or put their children in a private school, must their children stay in a public school that's not right for them? Instead, it's an opportunity for that child to move back to the front of the line.

This is hardly an earth-shattering new idea in America. After World War II, tens of thousands of returning veterans were given federal funds to attend the college of their choice. Critics said the sky would fall, but the GI Bill expanded educational opportunities and created the best higher education system in the world. What the GI Bill did for veterans in higher education, a GI Bill for Kids would do for poor children in our elementary and high schools.

'WASHINGTON KNOWS BEST'

One of the dangers to keep an eye on today is the federal government's continuing effort to control education. Despite the strong belief on the part of most educators and companies that the best way to improve the education of K-12 children is to find local solutions, there are still some who feel that "Washington knows best." As one bumper sticker you see around the country puts it, "I love my country, but I fear my government."

True, the federal government accounts for only about six percent of the monies spent nationwide on education. And there is a strong tradition of local control in American education. But people are afraid



Wired-in kids learn by interacting with a teacher and with computers supplied by Tandem.

Terri Guthrie may never win a Nobel Prize, but maybe one of her students will.

There's not a Nobel Prize for teachers, but Terri Guthrie of Jackson Middle School in Titusville, Florida, is good reason for creating one.

In just her second year of teaching, Ms. Guthrie has mastered a rare skill—the ability to make a seemingly dry subject (in her case, Earth Science) exhilarating.

She attributes much of her ability to the four weeks she spent at the Academy for Teachers of Science and Math at the University of Tennessee. It's an intensive, hands-on program that teaches how to motivate students in personal and imaginative ways.

As a major Academy underwriter, Martin Marietta is proud to join government and academia in supporting excellence in education.

And we're even prouder to know that thanks to Martin Marietta Fellows like Terri Guthrie, more students are getting turned on to math, science and the environment.

Who knows, one may even some day win the first Nobel Prize. For teaching.



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that Washington "experts" will impose on public schools their views about everything from safe sex to world history.

This is not just the ranting of some fringe group. Turn on C-SPAN, and you'll see people talking who actually believe that Washington does know best when it comes to improving our schools. In fact, Congress recently passed a bill – Goals 2000 – that turns the national reform movement into a federal program. It creates a sort of federal school board that will undermine local control. It also encourages mushy, so-called "outcomes-based" education instead of focusing on whether children are learning the academic basics.

Nothing could be worse for our schools than to increase centralization and rule-making – just when the rest of the world is rejecting that approach.

Communities and parents can do a better job than Washington deciding what is best for their children's future.

THE PATH TO EDUCATIONAL REFORM

In the immediate years ahead, the independent public school or charter school movement is sure to take off. Why?

- It already commands bipartisan support.
- It tackles the whole problem of improving education at once, school by school, instead of wearing everyone out with piecemeal arguments.
- It sidesteps the debate about whether public dollars may find their way into "private" schools.



Students at School #49 in Indianapolis, Indiana, one of 94 EDS school partnerships in six countries, work on writing skills with the help of Kim DiaBiaggio, EDS volunteer and partnership coordinator.

Soon, most everyone will see the inevitable logic of letting taxpayer money follow children to the schools that their parents believe will best fit their needs.

■ The "independent" orientation gives talented, committed educators an opportunity to work together and design new schools from scratch.

All in all, the concept has broad appeal. It can spur community support – and therefore win taxpayer backing – for school improvement.

The Logic of Choice. Ten years from now, people will be trying to remember just why anyone was opposed to school choice. It should be obvious now why we must allow families, especially the poorest ones, to choose the best schools for their children – unless we want to create a society with a third permanently stuck on the lowest run

of the economic ladder.

But the logic of school choice will become even clearer once charter schools flourish. Let's say Detroit creates a high school for eleventh and twelfth grade students who don't want to go on to college. No one will force students to attend such a school. But those who find the option just what they want and need will make it their choice. By the same token, schools that immerse students in Spanish or English, stay open until 6 p. m., emphasize math, or operate at a corporate headquarters all have an appeal for individual families.

Soon, most everyone will see the inevitable logic of letting taxpayer money follow children to the schools that their parents believe will best fit their needs.

Flexibility is the keystone. In the future you can count on seeing schools like those in Murfreesboro open virtually all the time, with parents choosing the hours that fit their family's needs and paying the extra costs (assuming they're reasonable) for the extra time. School districts that simply offer year-round classes will find it easier to attract parents' participation and financial support than those that require year-round attendance.

The Value of Home Schooling. The one school that is already open twenty-four hours a day is the American home.

With parents becoming more concerned about what's happening in schools, it's understandable that there would be a surge in home schooling. And it's not as worrisome a prospect as some people think.

More and more parents are turning their homes into schools because they believe the public schools to which their children are assigned are unsafe, unclear, or second-rate, or promote value systems they don't like.

What is likely to happen is that home schooling will



Two-day Teacher Training Institute Seminars provide teachers with the training materials to intergrade technology into classroom instruction.

into a kind of sensible catalyst for more parent involvement in children's education. In the end, most parents will want their children to have the advantages of attending a school outside their neighborhood. They don't want to carry the whole burden of education through home schooling. We create new schools, improve existing schools, give parents more choices, education may swing full circle back to the way things were: the parent as the primary teacher – with schools providing supplemental information to enhance a child's overall education.

School Board as Overseer. In this fast-forward view of education's future, the nation's 15,000 school boards will find themselves performing a job that's different – and more interesting than – the role they have played like overseers, they'll set policy and nurture the development of schools that really meet the needs of students and children in their communities. Instead of creating and managing schools and then assigning each child to one of them, boards will step back and open the door to the best proposals for helping children learn. It will be the community that creates the school. The school board's job will be to make sure children are learning what they should – in a safe, clean environment. As long as parents choose among schools, government money should follow the child into the classroom.

A Revolution in Public Education.

No doubt, there's a consensus developing that will revolutionize what we call "public education."

The need to redefine education in the public sector comes from America's new awareness that events that seem to be remote – the capitalist uprising in the Soviet Union and Eastern Europe, the emergence of strong economies along the Pacific Rim, and other changes reported round-the-clock on television – have an impact right in our backyard. They have forced our country to restructure its economy, decentralize corporations, and adapt our production processes to new, rapidly evolving technologies.

For our society's work force it has been a wrenching series of changes. Today, thoughtful educators and businesspeople alike are asking: If our corporations have gone through a transformation, setting new goals and developing new tools, why shouldn't our schools do as well?

Many American parents recognize that most of our schools are still designed the way they were two or three generations ago when you attended classes three months a year until fourth grade and then went to work in the fields. It's not quite that bad these days – but almost.

It's not surprising that with our schools in a time warp and the nation in need of a greatly upgraded work force, the private sector is thickly involved in trying to transform our schools. How can you build better products, against stiffening foreign competition, without well-educated workers?

Now, a dozen years after the U. S. Department of Education sized up America's educational performance and concluded, "The nation is at risk," companies can look at a mixed scorecard of successes and failures. Their stake in education however is already large. And corporate interest is certain to accelerate.

What's so compelling in the nineties is the need for action rather than talk – that's the credo for today and tomorrow. It's clear that companies, like ordinary citizens with kids in school, believe that time is running out in the exasperatingly slow drive to make American education better. ■

Lamar Alexander has been Governor of Tennessee, President of the University of Tennessee, and U. S. Secretary of Education. He is a Senior Fellow at the Hudson Institute where he directs the Project on The Promise of American Life. He lives in Nashville where he is counsel to the Baker, Donelson law firm.

Paul Burnham Finney, who writes about education and business, assisted in the preparation of this report.



To Help Our Kids Become The Employees We Need We All Have To Go Back To School.

The gap between the skills employees need and the skills they have is growing. Nothing less than a world-class education can narrow it.

And that can happen only if employers go into the schools to help make it happen. Not just to donate equipment or an employee's time now and then. But to make a commitment to be part of the system

today and in the future.

That's why BellSouth sees the new School-To-Work Opportunities Act (STWOA) passed by Congress as a much-needed call to action for all sectors of our community to work together in new ways, and create the kind of educated work force business, and America, need.

Like us, a lot of businesses want to do more and are doing more. BellSouth is

committed to showing educators the work skills students need to compete. In fact, we are already bringing students and teachers into the workplace, so they can learn first-hand the skills that are required.

We are excited about the state and local initiatives that STWOA will fund. And we're taking our place in today's classrooms. Front row and center.

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ING TRACK: Penske does everything from running the pits at Indy to building relations with the UAW

mid-June, the day before a 300-mile stock-car race at his Michigan International Speedway, Roger S. Penske got word that a brutal heat wave had softened an 800-foot stretch of track's new asphalt. If the pavement melted, as it threatened to do, the race might not run and Penske would lose money and suffer the sharp embarrassment of disappointing 100,000 fans, a host of sponsors, and a national television audience.

er Penske doesn't tolerate emasculation. So the silver-haired former race-car driver picked up a pusher, grabbed a dozen of his employees, and worked until 1:30 the next morning alternately scrubbing lime into the track and running cold water over it

in a feverish effort to harden the surface. It worked. Just 12 hours later, two dozen stock-car drivers were zooming around the two-mile oval at 180 miles per hour.

That the 57-year-old chairman of a \$3.6 billion transportation empire would risk blisters to save an auto race was no surprise to the employees of Penske Corp. Their chief executive may demand hard work, but nobody works harder than Penske himself. While indisputably the boss, Penske doesn't stand on ceremony. For him, business is like a race car: Every part is crucial, and they must all work together. "If I'm not motivated and interested in the results, how do you expect the rest of the organization to be?" he asks.

Penske's toil has paid off in one of America's most successful entrepreneurial ventures. In 1964, he bought a Philadelphia Chevrolet dealership and parlayed it into a transportation conglomerate that ranges from his nearly unbeatable Indy car racing team to Detroit Diesel Corp., a giant maker of heavy-duty diesel engines (table, page 158). Penske does everything from running the pits during the Indianapolis 500 to forging good relations with the United Auto Workers. Imagine the head coach of the New York Giants owning the team, several of the stadiums it plays in, and a \$1.7 billion sports-equipment maker. Then imagine him being successful at it.

Success has rained on Penske this

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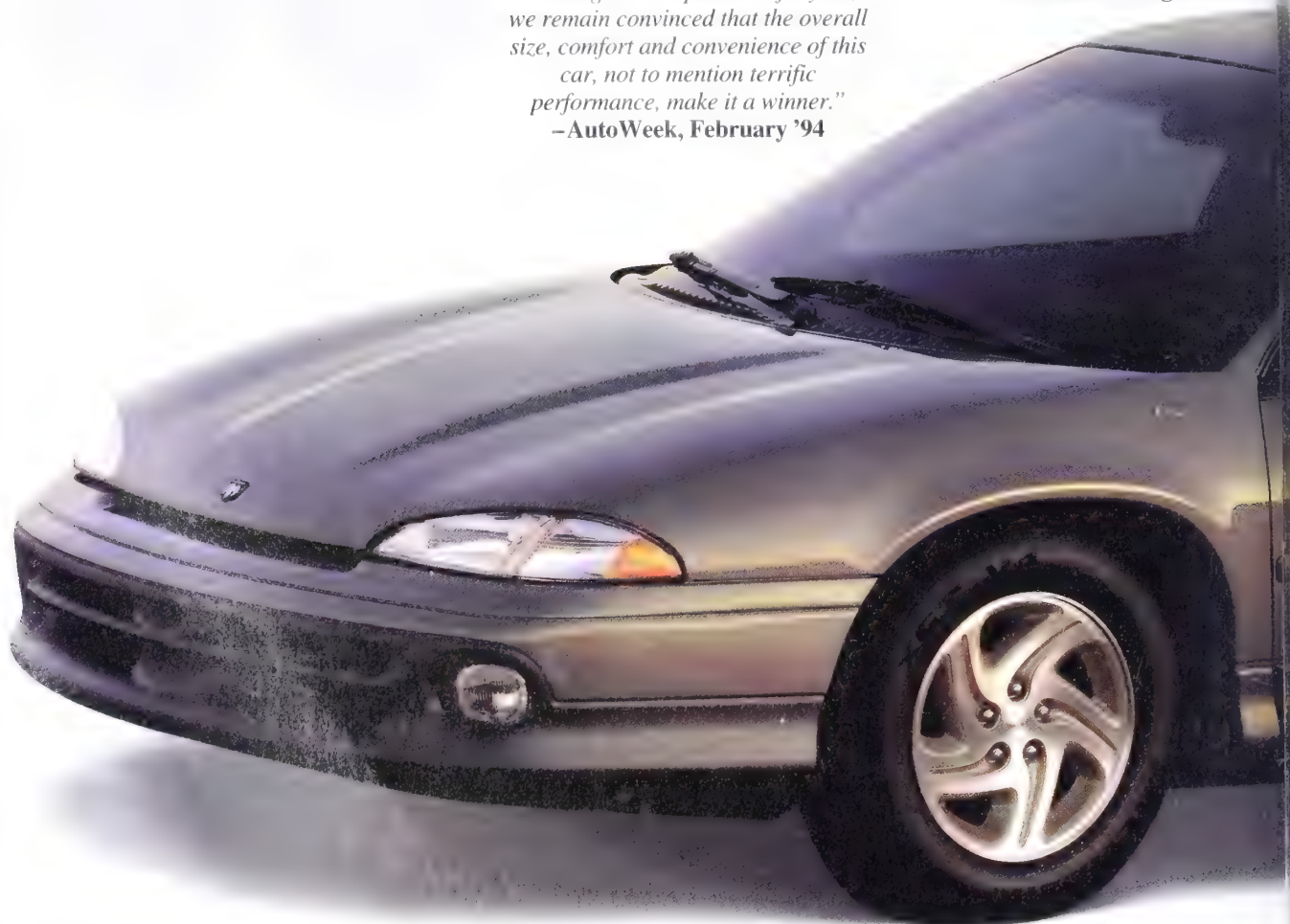
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"Automobile of the Year, 1993, All Star, 1994"

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—Worth Magazine,
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Intrepid



The New Dodge

A Division of The Chrysler Corporation

Detroit Diesel's share of the heavy-truck market has soared from 3% to 25% since Penske took charge in 1988

year. Detroit Diesel's share of the heavy-truck market has shot from 3% to a remarkable 25% since 1988, when Penske bought a majority stake in the former division of General Motors Corp. Earnings have surged for a third straight year (chart). So far during the 1994 Indy car season, which wraps up on Oct. 9 with the Monterey Grand Prix, Penske's three-car team has clinched 11 victories in 16 races, including five 1-2-3 finishes. Lead driver Al Unser Jr. won both the Indy 500 and the overall Indy Car points championship.

CHECKERED FLAGS. For Penske, however, success carries its own burdens. He acknowledges that stress is a persistent adversary. Last year, after falling ill during a speech, he spent a couple of days in the hospital undergoing tests. His doctors gave him a clean bill of health, but he'll see no letup in the pressure as he tries to keep the company's momentum going. For all of Detroit Diesel's newfound strength, its results are still prey to the highly cyclical market for truck engines—a market analysts think is peaking. And higher interest rates pose challenges for all of Penske's businesses.

Consequently, Penske is searching for new markets. Through a series of new, multifaceted partnerships with other companies—most notably Daimler Benz—he has found several new products for Detroit Diesel to sell. He has also set the stage for overseas growth and has given his racing organization an important boost.

To see how these relationships work, you first have to understand the symbiotic nature of Penske Corp. Auto racing is most definitely an affair of the heart for Penske, but he is too much of a pragmatist to annually spend the \$5 million plus per Indy car just because he loves it. Penske's glowing results on the Indy Car circuit (a record 90 checkered flags, including 10 at the Brickyard) cast a halo over the entire organization—from giving Penske car dealerships added allure to opening doors for engine salespeople.

Penske invited some 300

truck-leasing customers to his track in Nazareth, Pa., for the Bosch Spark Plug Grand Prix. On Saturday afternoon he trooped over to a hospitality tent with his three star drivers: Unser, Emerson Fittipaldi, and Paul Tracy. The foursome chatted and posed with a line of people who wanted their picture taken next to a Penske race car. During the turnaround, that sort of schmoozing helped Penske win back customers at Detroit Diesel. Fleet owners disgruntled with GM were all ears when meeting with an Indy Car hero.

Penske designs his outside business partnerships to nourish as many parts of the company as possible. Robert Bosch, for instance, not only sponsors the Nazareth race and the Indy team but is a 50% joint-venture partner with Penske in Diesel Technology Corp., which makes high-tech fuel-injection systems.

Then there's Daimler Benz. The German industrial giant currently owns 20% of Detroit Diesel and will help fund race-engine development at Penske's part-owned British subsidiary, Ilmor Engineering Ltd. A Mercedes/Ilmor engine

this year blew away the field in the 500. Mercedes-sponsored engines power Penske cars during all of season.

More important, however, is Mercedes and Detroit Diesel teamed up to enhance a Mercedes engine with Detroit Diesel technology be called the Series 55 in the U.S.

will fill a key niche: smaller engines now scant in Penske's line. And it will do so for \$300 million, rather than \$3 million cost of developing an engine from scratch. Penske is partnering up to attack marine and industrial markets. He recently joined with Germany's MTU Motoren-und Turbinen Union Friedrichshafen to develop engines of up to 35

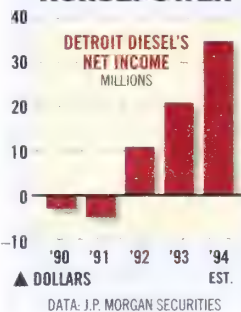
horsepower.

Penske is hoping his new European friends can help him double Detroit Diesel's foreign business to 20% within the next 10 years. But will overseas stretch the boss too thin? Penske runs the parent company as just a few other executives. And though he has strong management

each of his divisions, he is closely involved in the operation of each of them. His 1988 acquisition of Potamkin Cadillac in New York City showed what happens when Penske gets distracted by too many projects at once. While he was busy turning around Detroit Diesel, the dealership lost \$1 million before he sold out in 1992. "I might have overlooked the plate a bit there," he concedes.

"SYSTEMATIC." Penske is the most compulsive when it comes to order and preparation. "I never saw as systematic and thorough a person," says David Atlas, a former Penske Corp. lawyer. At this year's Indy 500, for instance, the new Mercedes engine posed a tricky problem. Its horsepower was so great that it threatened to heat up the Penske cars' tires to the point where

EARNINGS HORSEPOWER



PENSKE'S \$3.6 BILLION EMPIRE

\$1.7 BILLION*	DETROIT DIESEL Manufactures diesel truck engines. Penske owns 51%, Daimler Benz owns 20%, the public owns the rest.
\$1 BILLION	PENSKE TRUCK LEASING Lessor of truck fleets. GE Capital owns 50%.
\$120 MILLION	DIESEL TECHNOLOGY Makes electronic fuel-injection systems that it sells to Detroit Diesel and other engine builders. Robert Bosch owns 50%.
\$750 MILLION	CAR DEALERSHIPS Penske owns six dealerships in Southern California selling Cadillac, Saturn, Toyota, Lexus, and Honda. Longo Toyota is the largest car dealership in the world.
\$65 MILLION	AUTO RACING Includes two speedway properties in Michigan and Pennsylvania; an Indy Car team and a NASCAR team; Ilmor Engineering, a British race engine builder; and Motor Sports International, which sells T-shirts, hats, and other merchandise.

*Revenue figures are full-year estimates for 1994

DATA: PENSKE CORP., BUSINESS WEEK ESTIMATES



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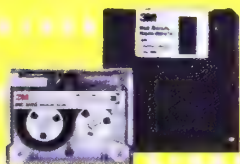
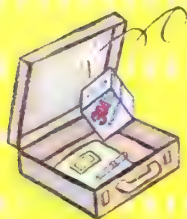


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People



GLORY DAYS: *Penske's team—including Indy champ Al Unser Jr.—has been*

they would lose their grip on the track and wipe out any advantage the engine could provide. So each of Penske's three teams double—"cured" eight full sets of tires, exactly the number they'd need for the race. Curing involves running new tires for a couple of laps until they're good and hot, then taking them off the car to sit for two days and harden. Most teams can hardly find time to do it once.

Such a hard-driving environment isn't for everyone. Salespeople at Penske's car dealerships, for instance, must hew to a strict dress code: no sunglasses, no beards, business attire with neckties pulled tight. New hires at any Penske business who chafe under such rules usually wash out quickly. And longtime Penske employees are expected to keep pace with the boss. In 1971, when Penske had a Lear jet delivered, he called his top lieutenant, Walter P. Czarnecki, at home on his birthday and asked him to come and help wax it. Says David Atlas: "If you really dropped the ball, he would look at you with those steely blue eyes, and if you had half a brain you knew what you had to do."

FREE PASSES. Penske's greatest knack as a manager, however, is fostering employee loyalty. Some say they're inspired by his tirelessness. But his respect for workers' personal needs and desires is what seems to make the difference. Penske treats them like valued players on a winning team. As long as they work hard, he takes care of them.

This is most evident at Detroit Diesel. When Penske first took over, he quickly determined that the big engine maker's problem was not a lack of good prod-

ucts but a lack of motivation. The service force had been rendered slow and apathetic by GM's bureaucracy, and the blue-collar force was demoralized. Penske laid off many salespeople and empowered those who remained to do whatever they could to encourage customers to at least try Detroit Diesel's new Series 60 engine. He even persuaded customers of Penske Truck Leasing to take the Series 60 in some of their leased trucks so they could compare its fuel efficiency with other engines.

To rebuild trust with factory hands, Penske played the race-team card by inviting all employees and their families to Michigan International Speedway every other year for a free day at the track. More important was to renegotiate the profit-sharing agreements to give line workers more money. He also committed to meet with groups of employees three times each year to lay out information on earnings, productivity and capital investments. And he gave the union veto power over outside contractors and suppliers. "I don't agree with them all the time, but we're not in a confrontation mode, we're in a solution mode," Penske says. Agrees Ed Brown, chairman of United Auto Workers Local 163: "Roger has developed a lot of credibility with us."

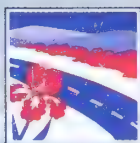
Penske says his passion for details stems in part from the three summers he spent at a camp run by Indiana's Clover Military Academy. He was a serious kid, and that experience made him more so. He grew up in Shaker Heights, Ohio, a well-to-do Cleveland suburb, the oldest son of Julius Penske, a metallurgical engineer, and his wife,

TENNESSEE

PACKET TO TOMORROW

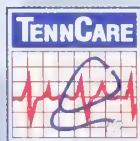


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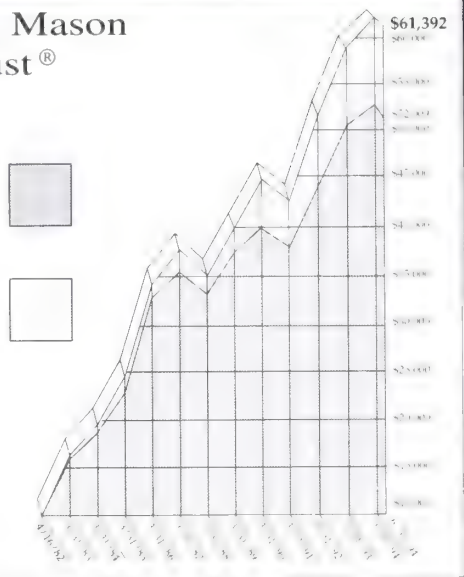
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People

Martha. Penske's car-racing career began while he was studying market and business at Pennsylvania's Lehigh University.

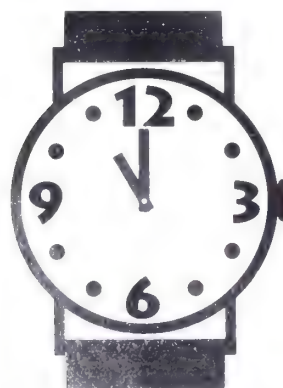
Penske bought a 1957 Corvette and he worked on in an off-campus garage and began competing in local hill climbs. After graduating in 1959, he took a job selling aluminum siding for Alcoa and raced on the weekends. By 1962, *Sports Illustrated* and *The New York Times* had named him driver of the year. Two years later, mechanic Clint Brainerd offered Penske a ride in the Indy 500. But work commitments interfered. When he later bought the Chevy dealership, he abruptly ended his driving career because his bankers demanded expensive insurance if he persisted in racing. **NO TIME.** Business has always come first and that has taken a toll on Penske's personal life. In the 1980s, when Penske Corp.'s headquarters were in Parsippany, N.J., he often slept at the Hilton Hotel across the street rather than

What's next? Penske is flirting with the idea of a Formula 1 team for the European circuit

drive an hour home to Red Bank, NJ. Finding time for his five children by two marriages has never been easy. Penske's hardworking ways helped scuttle his first marriage to Lisa Stouffer, daughter of Gordon Stouffer, who founded the hotel and restaurant chain. His second wife, Kathryn, whom he met in 1970 on a Vail (Colo.) ski trip, attends many Indy races. But her husband's frenetic pace leaves little time for togetherness.

Penske isn't likely to lighten up soon. He flirts with the idea of launching a Formula 1 team on the European circuit. The exposure, after all, would help his business push there. Penske, who won the Puerto Rico Grand Prix in his driving days, was less successful during the 1970s as a Formula 1 car owner. In two years of painstaking work, he managed only one victory, and driver Mark Donahue—his best friend—died in a crash during practice. At a recent dinner with Unser and Fittipaldi, Penske half-jokingly asked if they were going for another Formula 1 bid. Both gave thumbs-up. Perhaps Penske would be better off asking himself: Does he really have the time?

By David Woodruff in Nazareth, Pa.

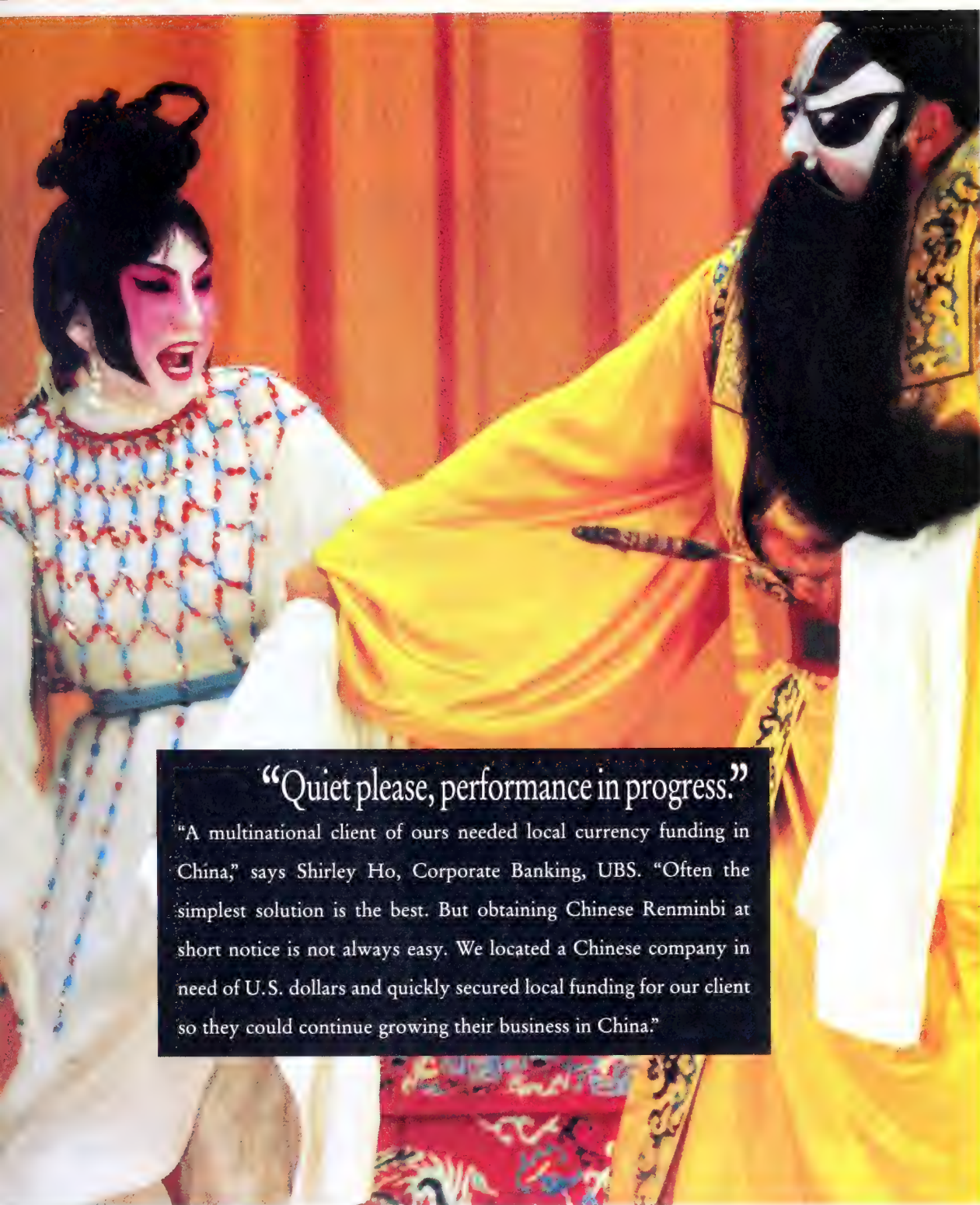


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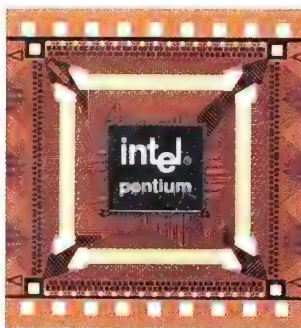
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N UGLY BACKLASH OVER SPINAL SURGERY

Legal fight is brewing over procedure that fell into a regulatory gray area—and which many say is too risky

Holly G. Swedeen felt lucky. It was a clear day nine years ago when, while driving her three foster kids, another car slammed into her on driver's side. She and the children fled away from the accident. It wasn't until the next morning that Swedeen realized something terrible had happened: She couldn't move.

Swedeen's back had been severely injured. She was in constant pain when her doctor offered the former secretary, 30, hope. He told her that a new off-the-art surgical procedure at stabilizing her spine would end her troubles.

In 1988, Swedeen underwent the delicate operation, known as pedicle-screw fixation, which involves implanting metal plates and screws into a part of the spine to immobilize it and allow it to heal. The devices have helped thousands of patients overcome serious back problems and resume normal lives. But after surgery, Swedeen is in many ways less off than she was before. She can't walk without a cane. Movements as simple as rolling over are agonizing. And she no longer has control over her bladder and bowels.

WARNING FOR CLIENTS. Swedeen knew surgery was risky. But she says she didn't know that implanting plates and screws in the back to stabilize the spine had not been approved by the Food & Drug Administration. "I was only told this was like *Star Wars* technology," Swedeen, who in January founded the Citizens Against Pedicle Plates & Screws Assn. in Carson, Wash. "It was a sales job, and I fell for it." (Swedeen has not sued her doctor.)

Swedeen, whose organization already has nearly 2,500 members and chapters in 15 states, wasn't the only buyer. The estimates that since 1985, as many as 100,000 people may have undergone



DISABLED: Holly Swedeen (with husband Keefe) says she fell for "a sales job"

the costly surgical procedure. And many of them say they were never warned about the risks or the lack of regulatory approval.

Now, the controversy has attracted the interest of high-powered plaintiffs' lawyers, many of whom believe that problems associated with pedicle plates and screws are seeds for the next major product-liability battle. Already, at least three class actions have been filed against manufacturers in addition to dozens of other cases brought individually against manufacturers, doctors, or hospitals. And plaintiffs' lawyers have run ads in newspapers nationwide seeking potential clients. "This is something that fell through the cracks of the system," says John P. Coale, a plaintiffs' lawyer in Washington who represents about 2,000 patients. "The thing about this is that the damages per case are high because these people are really screwed up."

One of the plaintiffs' main allegations is that the devices are inherently defec-

tive because the screws can break or bend inside the body. That can render the device too weak to stabilize the spine, they charge. Depending on the manufacturer, the screws are made of stainless steel or titanium. In addition, plaintiffs' lawyers allege that manufacturers illegally promoted and sold these devices without evidence that they were safe and effective for use in spinal fusion. "These devices have been overused and misused for spinal conditions for which there has never been any scientifically valid evidence that they worked or are safe," says Gary A. Eaton, a lawyer in Tulsa who represents some 800 patients.

HANDS OFF. The defendants, which include Cleveland-based AcroMed and Memphis-based Sofamor/Danek Group and Smith & Nephew Richards, deny any wrongdoing. They argue that everything they have done has not only complied with the law but also has helped people who otherwise would still be plagued by pain. The problems some

Manufacturers deny any wrongdoing, saying patients' problems stem from normal surgical complications

unfortunate patients experience, they say, stem from the normal complications that arise from any difficult surgical procedure. "The fact that this doesn't work all the time isn't a surprise to anybody," says Mark Herrmann, AcroMed's lawyer. "But it works far better than any other alternative available to these patients."

On the face of it, the pedicle-screw controversy seems like one more messy product-liability battle. Yet this fight is different. It turns on a difficult and murky issue: how to ensure public safety without inhibiting innovation.

Pedicle-screw manufacturers and many spinal surgeons who favor the device as the most sophisticated treatment for certain spinal conditions contend that advances in medicine come from the community that works with patients every day—not from a government agency. That's why the FDA allows doctors to decide how best to treat their patients. "The FDA doesn't try to regulate the practice of medicine," says Dr. D. Bruce Burlington, director of the agency's Center for Devices & Radiological Health.

In this case, while the FDA did not specifically approve the screws and plates for use in spinal fusion, it found them to be substantially equivalent to similar medical devices approved for use in the leg and arm. Once on the market for those procedures, surgeons could legally use the devices in other ways they believed would help their patients, including in the spine. But companies are barred from promoting the devices for such unapproved uses until the FDA finds that clinical data support them as safe and effective.

RECORD OF SUCCESS. Applying treatments in so-called off-label ways is a common medical practice—and a legal one. "We don't need a study to know what we've been doing is successful," says Dr. Ronald L. DeWald, a surgeon in Chicago who has successfully performed hundreds of pedicle-screw operations. "Some things are self-evident."

DeWald's point is buttressed by the findings of a study recently conducted for the FDA's Orthopedic Advisory Panel. In July, a scientific committee found that for spinal fractures and a condition known as degenerative spondylolisthesis, pedicle-screw fixation was superior to other treatments. Based on the

records of nearly 3,500 patients, the study found a 90% success rate for certain conditions. The committee recommended that the FDA reclassify the devices so that they can immediately be promoted for spinal fusion. "This study proved unequivocally that pedicle screws are safe and efficacious for unstable spine conditions," says Dr. Hansen A. Yuan, chairman of the FDA's scientific committee. The FDA is still weighing the panel's recommendation as well as critics' claims that the study is flawed.

Yet with the new supporting data in hand, the pedicle-screw controversy—and legal morass—is far from settled.



That's in part because what sometimes happens when promising new devices and procedures become popular with the medical community too quickly. While the FDA permits use of these devices by physicians, all too often unqualified surgeons

use them improperly. As pedicle-screw fixation gained in popularity, regular and doctors began to suspect that a precisely what was happening. "There's probably a fairly significant number of cases done with poor [patient] selection and that's what's causing the bad results," says Yuan.

NO CURE-ALL. In hindsight, the FDA admits it should have cracked down sooner on the promotional practices of the manufacturers and should have demanded quicker completion of clinical trials. "The public would have been better served if the medical community, the companies, and the agency had acted responsibly to ensure that the companies started with systematic examination of the devices," concedes Burlington. "That didn't happen."

Medical device manufacturers say the FDA has stepped up enforcement of illegal promotion of unapproved treatments. But plaintiffs' lawyers contend the agency still isn't doing enough—particularly in the pedicle-screw case. Although the FDA sent numerous warning letters to manufacturers threatening action if they didn't stop the practice, opponents say those moves have been meaningless. FDA's Burlington maintains that the agency did all it could. "The companies have a responsibility to the patient and to the FDA to have systematic data to support the use," he says. "They were acting illegally and we moved against them."

For their part, the companies deny the charges and say the agency was fully aware of their activities. Still, no one claims that pedicle plates and screws are a cure-all. The thousands of disabled patients such as Swedeen attest to that. What is less clear is who—if anyone—is to blame. As new medical technologies and procedures proliferate, some failures are inevitable. The question is, who should decide at what point the failures outweigh the benefits of success?

By Linda Himelstein in New York, with John Carey in Washington

HOW PEDICLE SCREWS GOT TO MARKET

December, 1985 AcroMed files application with FDA seeking approval to market its spinal fusion device. Application denied.

March, 1986 AcroMed resubmits its application for use in some bones, but not the spine. This time, the FDA grants approval, paving the way for surgeons on their own to use the device as they see fit.

1988 Cases begin going to trial against manufacturers, doctors, and hospitals with both plaintiff and defense verdicts.

1990 AcroMed's insurer settles 22 pedicle plate and screw cases for \$5 million.

February, 1994 Class action filed alleging product defects. Defendants deny any wrongdoing. Other lawsuits are filed.

July, 1994 FDA advisory panel finds pedicle plates and screws to be as safe as and, in some cases, more effective than other spinal fusion treatments. Panel recommends that the FDA reclassify the device so it can be marketed for use in spinal fusion.

August, 1994 Class actions are consolidated into one federal case in Philadelphia.



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ANGRY ELDERS: Retirees protest the skimpy government pensions in a demonstration at the Pink House

LATIN AMERICA

WILL ARGENTINA STAY THE COURSE?

Social unrest and election-year politics could jeopardize reform

Ricardo Matarese spent his youth hoisting cargo in the steamy port of Buenos Aires and saved enough to open a small coal-exporting business. But when hyperinflation and devaluations hit in 1991, he lost everything except his house and two cars. He's back working at the docks now and moonlighting as a taxi driver. "I've come down a few notches in the world," says Matarese, 49, shrugging his shoulders. But now that inflation is under control, he can buy an airline ticket on credit and take a vacation. "I'd never give up this economic stability," he adds.

Like many Argentines these days, Matarese is still savoring the fact that prices don't rise daily. But 3½ years into a stabilization program that

turned Argentina around, he also shares with others a nagging feeling that this is as good as it's going to get.

Thus begins the second, more difficult stage of Argentina's economic revolution: persuading an uneasy electorate to keep faith in the long-term payoff of market reforms. It comes just as campaigning begins for the May, 1995, presidential elections. President Carlos S. Menem, the charismatic leader who has led the dismantling of the

statist economy, will be facing disquiet over rising unemployment and lagging growth in the provinces. "The social costs of the economic transformation have been very harsh," says economist Miguel Angel Broda.

Argentina's economic policy has been a remarkable success (table). Economic Minister Domingo F. Cavallo has privatized dozens of state-run companies, from telephones to the national oil company. He turned a 5% budget deficit into a surplus. Argentina's manufacturing base was restructured, prompting a 42% jump in productivity. The economy has grown 30% in just three years, faster than any other Latin American nation. And inflation remains low, at this year.

PESO PRESSURES. But the restructuring has hurt, too. Unemployment has doubled, to nearly 11%, affecting mostly the middle class. Industrial exports were up 39% in the first four months of the year, but imports are surging even faster, and the trade deficit is expected to exceed \$5 billion this year. That will put pressure on the peso, considered sharply overvalued because of the 50% inflation since the peso was set by law at parity with the dollar in 1991. As public spending has expanded 60% since then, threatening to erode the budget surplus.

Argentina is still better off than many neighbors: Per capita income of \$8,100 is the highest in Latin America, and foreign-capital inflows totaling \$35 billion in the past 3½ years. Its well-educated workforce attracts foreign investors who want a manufacturing base to serve the 200 million consumers in the Mercosur free-trade zone, including Argentina, Brazil, Uruguay, and Paraguay.

General Motors Corp., which fled Argentina's economic chaos in 1978, has now returned to open a new, \$100 million factory in Córdoba province which

will produce 25,000 pickup trucks a year for domestic sale and duty-free export to Brazil. Argentine automobile and truck sales have jumped fivefold, from about 90,000 vehicles in 1990 to an estimated 450,000 this year. Director Leo Kuniq says he won flexibly

REFORM WINS SOME...

PRODUCTIVITY is up 42% over three and a half years

PRIVATIZATION has netted \$24.2 billion in cash and retired debt

INFLATION has been slashed from 2,300% a year to just 4%

...AND LOSES SOME

UNEMPLOYMENT is climbing fast, now stands at 10.8%

THE TRADE DEFICIT is rising, totaling \$6 billion this year

PREELECTION GOVERNMENT spending has erased budget surplus

DATA: BUSINESS WEEK

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workplace rules from the auto workers union that would have been unimaginable a few years ago. "Mentalities have changed incredibly," Kunigk says. "Before this surge of modernization, it would have been much more difficult to set up shop here."

Most analysts believe that Argentina's future is bright—if officials stick to tight fiscal policies. But it will be difficult to keep spending under control in an election year, especially in the 23 provinces, where bloated public payrolls contrast sharply with the federal government's cost-cutting. Still, Cavallo vows he won't bust the budget. "We've carried out the huge task of controlling expenditures and reforming the state to permanently eliminate many expenses," he told BUSINESS WEEK (box).

GROWING CONCERN. President Menem, while still popular, is slipping in early opinion polling. A big thorn in his side will be upstart candidate Carlos "Chacho" Alvarez, a dissident Peronist congressman. Alvarez vows to investigate alleged corruption in the Menem administration. And he blasts Menem for failing to offer job retraining and industrial reconversion loans. But Alvarez doesn't question most of Menem's economic policies.

To stave off challengers, Menem will have to address growing social concerns. In a late September speech in New York, Menem vowed to make progress "on the two scourges—unemployment and poverty." He'll need some quick results, especially in the provinces. Warns Francisco Macri, president of Sevel Argentina, one of the country's top industrial groups: "If there is much delay in solving the problems, we could see some unrest." Demonstrations in front of the Casa Rosada, the presidential palace, are frequent, including retirees protesting their skimpy government pensions.

Overall, most Argentines believe the country is finally stable. That confidence is reversing a decades-long brain drain. At YPF, the privatized oil company, President José A. Estenssoro has lured home 20 Argentines who fled overseas during the 1970s and 1980s. "They wouldn't have come back to work at the old YPF," says Estenssoro, "but now we can offer them a challenging future at a well-run, private company." The challenge facing Menem—or the next President—is to convince all Argentines that they have an equally bright future.

By Geri Smith, with Paula L. Green, in Buenos Aires

'TODAY, ARGENTINES ARE MORE REALISTIC'

Economy Minister Domingo Cavallo is the primary architect of Argentina's economic turnaround. He spoke with Mexico City Bureau Chief Geri Smith in Buenos Aires:



Q: How much longer will Argentina's reforms last?

A: They are going to last a long, long time because with the fiscal balance and the peso/dollar convertibility plan we have achieved stability. Producers are getting used to operating in that context, which is more challenging than the inflationary closed economy of before. Then, errors in business were covered up by the economic disorder. Now, errors immediately jump into view.

Q: What about the downsides, like 10.8% unemployment?

A: Unemployment will resolve itself if we can convince Congress to approve new labor laws. Our current laws are inflexible, very European-style. But [unions] are realizing this system is discouraging the creation of new jobs.

Q: Can Argentina sustain high wages?

A: Our workers' salaries are higher than in Brazil, Chile, and Mexico, but we can sustain that because we can continue improving productivity. Argentina invested in its people years before the rest of Latin America did, especially in education. That's an advantage we have over our neighbors.

Q: In Mexico, the poor in Chiapas revolted. Here it's the middle class that feels excluded.

A: Here the poorest sectors now vote for the government; it's natural because they were the most hurt by inflation. But traditional middle-class people are suffering the costs of eco-

nomic adjustment—[former] public employees in privatized companies, small shop owners, farmers. We do have a problem of a diminishment in the standard of living of a portion of the middle classes.

Q: So the euphoria of economic stability has worn off?

A: The Argentines are demanding. As long as that demand comes along with a willingness to make the necessary sacrifices and efforts, that's fine. The risk is that the Argentine get carried away by demagogic speeches. If people believe that the government simply has to print more money, for example, it would be terrible. But today, Argentines are more realistic. They aren't

"They aren't so easily bought by the demagogic promises of the past, and that's progress."

DOMINGO CAVALLO
Economy Minister

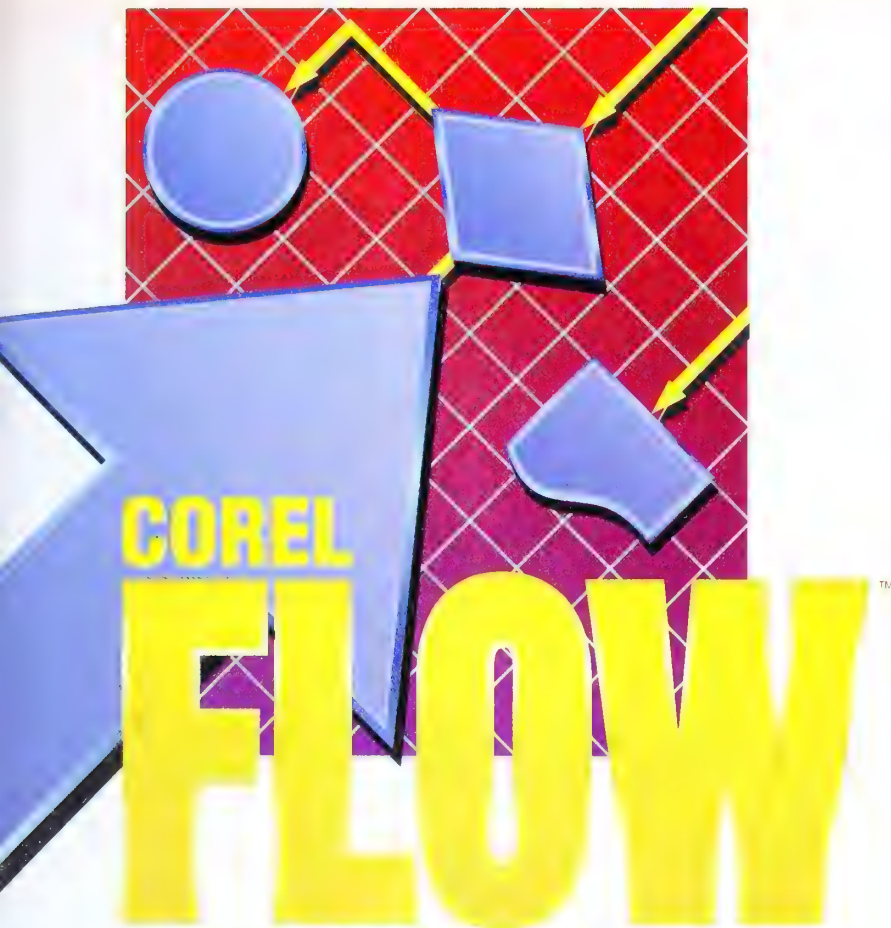
bought so easily by the demagogic promises of the past, and that's progress.

Q: What's next to be privatized?

A: The things remaining [to be sold] are important for increasing Argentina's efficiency. The investments that will be made in ports and airports will have a spectacular effect on trade, also for tourism. We're also going to privatize our nuclear power plants.

Q: Can Argentina keep sustaining the increase in its exports?

A: Argentina is going to be a great food exporter once again—not just wheat and meat but more processed foods with higher value added. And we'll emphasize natural products. We're beginning to export more wines, now. We'll also be an important exporter of energy. In manufacturing we're already exporting auto parts to Brazil. One Argentine company is exporting huge container cranes to Malaysia, Korea, and China, competing with the Japanese.



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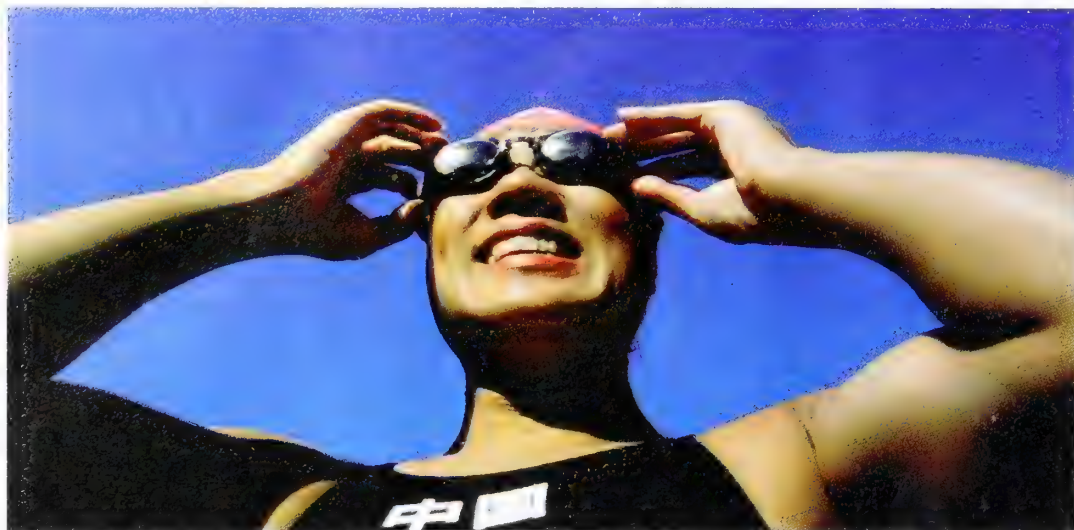
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COMMENTARY

By Skip Rozin

STERIODS AND SPORTS: WHAT PRICE GLORY?



When the young, green Chinese women's swim team splashed to six gold medals and three silvers in the first eight events at the world championships in Rome in August, rivals howled. Steroids, they charged. How else could anybody get so good so fast?

The accusation was never confirmed: None of the Chinese tested positive for drugs in Rome, although four other Chinese swimmers had failed drug tests earlier this year.

Still, the outcry cast a shadow over the competition and clouded China's victories at the Asian Games in October. The incident is just the latest in a string of steroid-abuse headlines that have rocked the sports world: Ben Johnson stripped of his 1988 Olympic gold medal, pro footballer Lyle Alzado's revelations of steroid use before his death from cancer in 1991, and the trial last summer of World Wrestling Federation honcho Vincent McMahon. (McMahon was acquitted.)

BLIND EYE. In the Age of Moneyball—the 1990s game of megacontracts and multimillion-dollar endorsements—sports seems to be sending the wrong message to young athletes striving for the deals that will set them up for life: It's O.K. to pop or inject steroids to enhance your performance.

Why does sports seem to be casting such a blind eye to steroid abuse? In a word: results.

"An athlete who is lackadaisical, who eats badly, sleeps badly, misses many days at the gym, works out without too much effort, and takes steroids can blow away an athlete who works out to the limit of his ability, sleeps perfectly, has a perfect diet, and in every other respect goes to the limit of his body," says Harrison Pope, associate director of psychiatry at Harvard Medical School.

Another reason for sports' ambivalence is that steroids' dangers have been debated since they were introduced to international athletics in the 1950s. While certain effects were anticipated and relatively common—acne, enlarged breasts, and high-pitched voice in men, deepening voice and prolifera-

tion of facial and hair in women—tellings of heart attack, strokes, liver and damage can seem extreme. "This does appear to be a killer," says Dr. Charles Yesalis of Pennsylvania State University. "I quote me as saying they're good for you, harmless, but I caution you more than a host of steroid deaths."

The legal use of steroids has been sharply reduced mostly to men unable to produce testosterone because of a pituitary gland problem, aging, or loss of testicular function. About 30 prescriptions were dispensed in 1993, according to Susan Koch of IMS International, the pharmaceutical marketing arm of Dun & Bradstreet Corp.

A NATURAL?
Chinese swimmer in Rome

total retail value of \$1.7 million.

LIGHT SENTENCES. The U.S. illicit market stands at about \$500 million a year, estimated an international enforcement on steroids in Prague last year. The supply is mostly smuggled from Europe and Mexico, and to a lesser extent from South America and Asia.

Federal officials spend thousands of hours each year prosecuting steroid users, with little effect. Even victorious athletes receive light sentences. A German nation-

victed in 1992 of smuggling enough methandrostenolone to produce 2.5 million steroid tablets, got a year in prison, a \$5,000 fine, and a suspended sentence. "The public just doesn't perceive the dangers of steroids," says Sean F. O'Connell, the U.S. prosecutor in the McMahon case.

And there is more physical cause for concern. "A significant minority of steroid users experience substantial psychiatric changes when they take drugs," according to

STERIODS: A RESUME

WHAT THEY ARE Anabolic-androgenic steroids are synthetic forms of testosterone, a male hormone that occurs naturally in the body. They can be taken either orally or by intramuscular injection.

EFFECTS Increase lean body mass; increase strength; increase muscle definition; decrease recovery time, permitting more frequent workouts; increase aggressiveness; increase acceleration.

DANGERS Potential reduction of HDL-cholesterol and elevation of LDL-cholesterol blood levels; testicular shrinkage; reduced testosterone production; benign and malignant liver tumors; bizarre, possibly violent, personality changes; feminization of the male and masculinization of the female; alterations in tendons; dependency syndrome.

DATA BUSINESS WEEK

"Maybe 1 person in 20 will be
 tible to these side effects and
 absolute Jekyll-and-Hyde
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 people on steroids have be-
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 300 steroid users. "We're
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 \$90 to \$1,600 a year.

LES. A large percentage of
 disciples of steroids are high
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 acities that sell television
 d fill stadiums." And if those
 amble, there are plenty more
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TELECOM REFORM IS BECOMING A LOCAL CALL

Washington faltered, but big regulatory changes are occurring at the state level

Is Congress irrelevant? You could reach that conclusion if you consider the telecommunications industry. With enormous fanfare, the Clinton Administration last January called for sweeping reform of federal telecommunications laws, replacing New Deal legislation with guidelines for the 21st century. The central theme was deregulation—let cable-television and phone companies compete with one another to quickly bring forth an Information Superhighway. The legislation passed the House easily in June, then died with a whimper on Sept. 23. Senator Ernest F. Hollings (D-S.C.) pulled the

plug on the Senate version after Senator Bob Dole (R-Kan.) came in with a list of “nonnegotiable” demands from the regional Bell operating companies (RBOCs).

But telecommunications reform lives on. State public utility commissions continue to change the regulatory landscape at a furious pace. And phone companies are busy overhauling their \$168 billion industry in preparation for a deregulated, multimedia future. Just four days after Hollings pulled the Senate bill, the New York State Public Service Commission announced an agreement to accelerate competition in all of

Nynex Corp.’s monopoly businesses in return for ending rate regulations that limit the carrier’s profits. Then, on Oct. 3, No. 2 long-distance carrier MCI Communications Corp. filed for permission to inaugurate local service in Illinois and four other states.

Capitol Hill gridlock has had little effect on telecom dealmaking as well. In September, AT&T won federal approval to purchase McCaw Cellular Communications Inc., making it the top player in cellular, with a potential entrée into local service. This summer, U S West and AirTouch Communications, Pacific Telesis’ wireless spin-off, announced

WINNING THE DEREGULATION BATTLE, STATE BY STATE

AMERITECH

Three of its states have replaced profit caps with rate regulation, which gives Bells more flexibility. Ameritech is seeking entry into long distance in return for competition in local service throughout its region.

BELLSOUTH

Seven states have flexible pricing plans; North and South Carolina still use profit caps. An Alabama federal court just approved BellSouth’s entry into cable TV.

PACIFIC TELESIS

California is poised to open up competition in the intrastate long-distance market and give Pactel rate relief.

SOUTHWESTERN BELL

Three states have liberal pricing regulations; the other three use profit caps. Texas is contemplating legislation that will open its telecom market completely to competition.

BELL ATLANTIC

First of the Bells to win federal court approval to provide cable TV in its own markets. All of its states have replaced profit caps with flexible pricing. Maryland granted a license to MFS Communications to compete on an equal basis in local service.

NYNEX

New York has proposed a plan to give Nynex freedom in setting rates, in return for wide-open competition in intrastate long distance. The plan will allow competitors to offer direct dialing, the first state to do so.

U S WEST

Six states still use profit caps. A Seattle federal court this summer granted U S West the right to offer cable TV in Washington.

DATA: BUSINESS WEEK, LEHMAN BROTHERS



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plans to merge cellular operations, as did Bell Atlantic and Nynex.

Nor are the states waiting for a cue from Congress. Indeed, many have already adopted changes proposed in the moribund federal legislation. About half the states have abandoned the age-old system of capping profits at a predetermined level. Instead they regulate prices—as the federal bill would have—and allow phone companies to earn whatever they can. This provides an incentive to upgrade technology and improve efficiency. All but seven states now allow competition for intrastate toll calls, although callers who choose a non-Bell carrier must dial a five-digit access code first. And nine states allow some sort of local competition, up from four at the beginning of this year.

OPEN THAT WINDOW. Lots more deregulation is in the works. Florida and Texas are both considering throwing their markets wide open to competition. A federal court in Alabama has ruled that BellSouth Corp. can provide cable-TV service throughout its nine-state region. U S West Inc. and Bell Atlantic Corp. won similar court rulings earlier this year. California lawmakers will open intrastate toll calls to competition on Jan. 1, 1995. "It's likely that the states see a window of opportunity to move ahead with their vision, now that there is delay at the federal level," says Lehman Brothers Inc. analyst Kenneth M. Leon.

Not all states are moving in the same direction, of course. "The larger states that have to compete on a global basis for business are moving ahead quite expeditiously on opening their markets," says Royce J. Holland, president of MFS Communications Co., an alternative local carrier. "It's the rural states that are lagging."

The problem with such a state-by-state approach is that it could create a regulatory crazy quilt. "How can you have a country in which New York State is in favor of competition and Pennsylvania isn't? What kind of a deal is that?" complains Federal Communications Commission Chairman Reed Hundt. "It's the Balkanization of our economy." Congressman Edward J. Markey (D-Mass.), chairman of the House subcommittee on telecommunications policy, says that a historic opportunity to establish a national policy has been lost, "and the only people cheering live in Osaka, Berlin, and Seoul." And, Markey asks: "What kind of nation depends



What kind of nation depends on the court system to set telecom policy?
REPRESENTATIVE EDWARD MARKEY
Democrat of Massachusetts

on its court system to set policy?"

Only the U.S.—because it's the only nation that has so thoroughly divided its local, regional, and long-distance markets. In so doing, it has given the states enormous power—approximately 80% of the phone revenues generated in the U.S. are regulated by the states. Other nations, however, are moving toward a consistent national or even continental policy—the European Union has mandated full voice competition for its member nations by 1998.

Unless or until a blanket federal law emerges, deregulation in the U.S. will proceed at whatever rate the states deem appropriate. New York is by far the most liberal. The state permits lo-

cal competition in several cities licensing non-Bell telephone companies such as MFS as equal carriers that can connect companies directly to long-distance carriers. Earlier this year, New York reached a groundbreaking agreement with Rochester Telephone Corp. The non-Bell company has agreed to allow MFS, Time Warner Communications, and other competitors equal access to its local exchange network in return for rate relief.

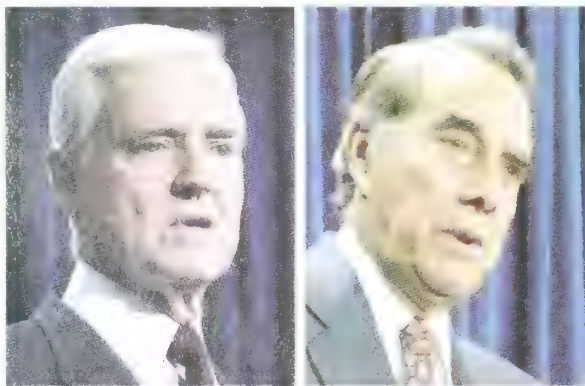
The agreement set the stage for the far-reaching Nynex deal, which will make New York the first state to permit consumers to dial intrastate calls directly with an alternative provider, eliminating the five-digit access codes. Nynex is in the process of working out a similar agreement with Massachusetts.

Maryland, Washington, Michigan, Wisconsin, and Illinois are also moving closer to open competition, licensing competitive local carriers and considering dial-1 service for in-state toll calls. Illinois is getting a push from Ameritech Corp., which filed a proposal with the FCC in March, 1993, asking permission to provide long-distance service in all its markets in return for giving competitors access to its local network. This proposal has given long-distance carriers fits. Ameritech says it would charge its long-distance unit the same access charges other carriers pay—typically accounting for 4% of their costs. But MCI, AT&T, and Sprint dispute that.

LONG DELAY. But it isn't very likely that the Ameritech plan will win approval at least not as long as Federal Judge Harold H. Greene presides over the nation's phone system. Greene, who has overseen the Bells since the 1984 AT&T breakup, wants to keep the RBOCs out of long distance as long as they have a monopoly in local calling. Four of the Bells filed a motion on July 6 asking Judge Greene to end his overseer's role, but the jurist has already said that he won't even consider the filing until next October.

Meanwhile, Congress is certain to try again with a new bill. Bob Hollings and Dole have promised to reintroduce telecom legislation next year. By then, the RBOCs may very well want a federal solution, especially if other states start following New York's example. At least then they would not have to keep up 50 lobbying efforts.

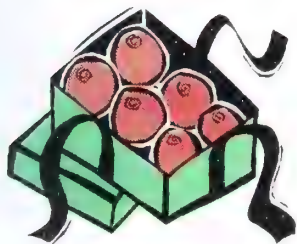
By Catherine Arnst in New York, with bureau reports



SECOND TRY: Hollings and Dole pledge bills in '95

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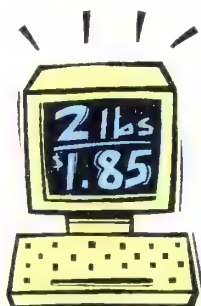
Is shocked by high shipping costs.



Goes to Post Office instead.

PARCEL POST

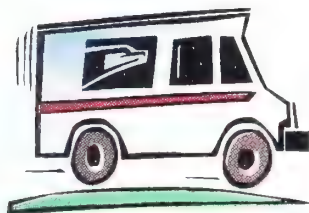
Finds out Parcel Post is a very smart solution.



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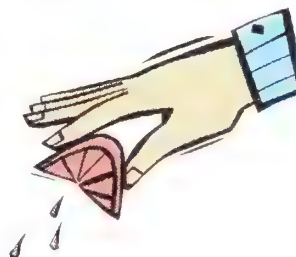
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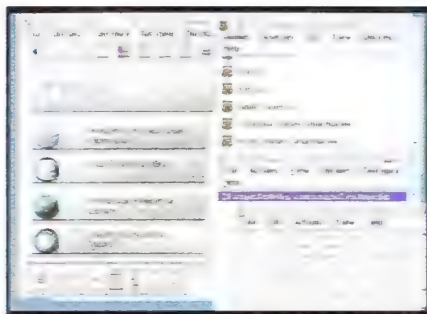
WINDOWS OF OPPORTUNITY FOR BIG BLUE?

Its new OS/2 debuts this month. Windows 95 won't arrive till '95

What's the hottest software coming down the pike for personal computers? Most folks would probably say Microsoft's long-awaited Windows 95, which has been in development for 4 years under the code name Chicago. That program will take advantage of the full power of 32-bit chips, look prettier than today's Windows, and, more than one application program to run simultaneously, and, in general, make life easier for PC owners. But there's a catch: The package, now dubbed Windows 95, probably won't be out until next April at the earliest.

That means IBM—at least for the next six months—could have the hottest operating system on the market. It's none other than OS/2, the operating system IBM has been selling—with little success—against Windows since 1990. A new version, nicknamed Warp, will debut on Oct. 11, boasting features comparable to those of Windows, including the ability to run Windows applications. And it has a few improvements over the Microsoft package, such as being able to run on machines with as little as 4 megabytes of main memory, something the current test versions of Windows 95 can't do well. In addition, a simple mouse click will install Warp and automatically identify a PC's setup. And a new user interface makes it easier to manage files and applications.

RAVE REVIEWS. OS/2 is also expanding on the Internet craze. The new OS/2 will include software that simplifies the process of connecting to and navigating the Net. IBM's new Internet Explorer, its Advantis network and is likely to



INTERNET ACCESS: Navigating the Net will be easier

charge in the range of \$10 per month for 10 hours of connection time, says Wally Casey, director of marketing for IBM's Personal Software Products Div. in Austin, Tex. The new OS/2 will be priced under \$100, with deep discounts for OS/2 customers who upgrade and for converts from Windows. IBM officials also hint that at least a few PC makers, including the IBM PC Co., will bundle the new OS/2.

OS/2 Warp is garnering rave reviews by testers. "Everything we've seen, we like," says David L. Cole, manager of information systems at Mobile Natural Gas Inc., which plans to roll out the new OS/2 to its users early next year. "OS/2 is now where Chicago wants to be in two years," says Cole.

But big corporate clients, always the best market for OS/2, aren't the main target this time. Big Blue is positioning the new OS/2 for consumers—a market that's near and dear to IBM CEO and former RJR Nabisco chief, Louis V. Gerstner Jr. "Lou brings a sensitivity to that kind of marketing," says Casey.

Home PC buyers account for only 10% to 15% of the 5 million copies of OS/2 sold to date, acknowledges Casey. But for OS/2 Warp—the consumer-friendly name under which the product is likely to be released—"we think that will automatically increase," he says.

For that to happen, the new OS/2 must attract more applications programs than earlier releases did. "If real estate is location, location, location, then operating systems are applications, applications, applications," says Jonathan Yarmis, an analyst with consultant Center Group Inc.

That's an enormous task. Microsoft sold more than 50 million copies of Windows, and 80% to 90% of PCs leave the factory with Windows installed, making it the No. 1 target for application developers. And IBM has a potential drawback: OS/2 may not be able to run the new crop of Windows 95 applications.

POWER OUTAGE? IBM has more rolling OS/2 than ever. Warp is the first idea for a new desktop software plan that eventually will involve object-oriented software, a technique for building programs from prefabricated blocks that IBM says will give it a market edge. The immediate plan calls for moving OS/2 to different kinds of hardware, including machines based on the IBM-Motorola PowerPC chip. This will be done via something called the Workplace "microkernel," a layer of software on to which various operating-system "personalities" can be added.

But the first microkernel port of OS/2 for the PowerPC has hit snags. Test copies have not been released to developers and may not be out by yearend. That's one reason IBM has been off introducing its own PowerPC systems for the PC market.

Not just software is at stake. The combination of OS/2 and PowerPC machines is IBM's strategy for winning back leadership in the all-important desktop computing market. An OS/2 flop would shatter those hopes, says John O. Dunkle, president of Workgroup Technologies Inc., Hampton, N.H., consulting firm. "Once

the desktop is lost, there's no coming back," Dunkle adds.

That's why Gerstner Jr. O.K.'d plans to spend tens of millions of dollars on a promotional campaign in the fourth quarter, part of a staggering \$500 million that IBM will shell out on R&D, marketing and sales efforts worldwide this year. It will be at least that much to push OS/2 sales to warp speed.

By Andy Green in Austin, Tex.

In This Corner...

OPERATING SYSTEM	ADVANTAGES	DISADVANTAGES
IBM OS/2	Its features are comparable to Microsoft's Windows 95, which it will beat to market by at least six months	Little market momentum; few applications designed to exploit OS/2 features
MICROSOFT Windows 95	As the 32-bit upgrade for Microsoft's vast base of MS-DOS and Windows users, it's the top priority for application developers	Delayed until second quarter of '95. Customers may hesitate to move to the first release. Microsoft must meet huge market expectations

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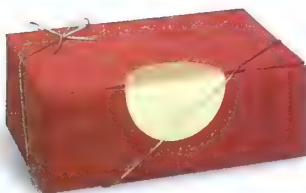


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SOFTWARE

AND NOW, FOR THE ARMCHAIR JET DESIGNER...

Parametric's new CAD program: No workstation required

Can a company become too successful? That's what investors are asking about Parametric Technology Corp., a Waltham (Mass.) manufacturer of software for computer-aided design. Sure, its Pro/Engineer mechanical-design package, used on Unix workstations to create everything from jet-engine parts to pacemakers, is No. 1, outselling programs from competitors such as IBM and Computervision Corp. And true, since 1988, the company has posted better than 50% annual growth, sending its stock from a split-adjusted \$2 in 1989 to \$44 a year ago.

Since then, however, Wall Street began to wonder if Parametric could keep up its winning streak, and the stock fell to the low 30s. Why? Although it's a big fish—sales are on track to reach \$250 million for the just-ended fiscal year—Parametric is swimming in a small pond. The market for mechanical-CAD programs for workstations is just \$1.2 billion, and annual growth has slowed to 6%. Frets one cautiously bullish analyst: "The question is, how big can this company get?"

POTENT COMBINATION. A lot bigger, if you ask Steven C. Walske, Parametric's 42-year-old chief executive. Walske, a onetime venture capitalist, has his sights on a new market: mechanical-design programs for the vast personal-computer market. The market has been dominated by Autodesk Inc., a \$419 million company whose main business has been selling its AutoCad package to architects. Walske first assayed the PC market in 1991 when he tried unsuccessfully to buy Autodesk.

Now, the PC market makes even more sense for Parametric. With powerful chips such as Intel Corp.'s Pentium, even inexpensive PCs can perform tasks that used to require an engineering workstation. Another advance:



WALSKE: The real push into PCs will begin in the fall

Microsoft Corp.'s Windows NT operating system handles three-dimensional graphics. That combination, says Peter J. Smith, CEO of design-software developer Swanson Analysis Systems Inc., has accelerated the use of PCs among design engineers. But, he adds: "It's just the tip of the iceberg."

Parametric is ready to pounce. "We've been studying and working on this for two years," says Walske. Since 1993, Parametric has sold a version of Pro/Engineer for Windows NT, which runs on engineering workstations such as Digital Equipment Corp.'s Alpha AXP machines. NT already makes up 15% of sales, but the real push into the PC market will commence this fall. That's when Parametric plans to begin briefing customers on a stripped-down version of Pro/Engineer that will run on Windows NT and Windows 95 as well as on Unix work-

stations. The program will cost about \$9,000, about half the price of the workstation package.

That's just the first step. Step two will be a push into the AutoCad market, where CAD programs sell for as little as \$500. Analysts such as Jeff Canin of Salomon Brothers Inc. say Parametric is likely to buy its way, spending a portion of its \$200 million cash. Parametric isn't tipping its hand, but in August it handed Senior Vice

President Louis J. Volpe additional responsibility, spearheading strategic diversification. "We are looking and will continue to look for potential acquisition candidates," Volpe says.

NO SHOO-IN. For now, the company can count on momentum. Canin sees revenue rising 35%, to \$335 million, this fiscal year that began Oct. 1, with earnings jumping to \$88 million from \$67 million. Meanwhile, the stock is climbing into the mid-30s, partly because of the emerging plan. Autodesk's customer, Medtronic Inc., a pacemaker manufacturer, is already leaning toward Parametric. [the PC version] looks as good as works like Pro/Engineer, and AutoCad users insist Medtronic would certainly

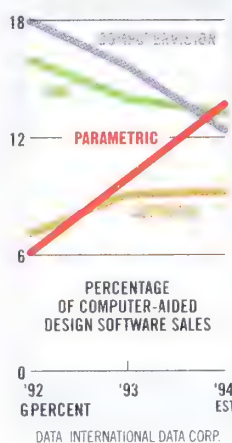
for it," says Design Supervisor Michael K. Berquist.

Still, Parametric is far from a shoo-in. In the workstation market, its toughest rivals—IBM and Computervision—were beset by financial and management difficulties. Not Autodesk. Under a new management team, the Sausalito (Calif.)

software developer has recovered its financial strength and wields a formidable sales network. Parametric has some 4,000 dealers, and Parametric's 125. Autodesk CEO Carol Bartz thinks Parametric will find the market a tricky balancing act. "If they don't price low enough, they aren't going to expand their market," she says. But, she adds, "pricing will chisel away earnings by drawing buyers from Parametric's higher-priced packages. Walske says he's not concerned. In all part of his grand design

By Gary McWilliams
Waltham, Mass.

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NOTHING BUT BLUE SKY AT NORTHWEST

With help from its unions, the carrier has shrunk its way into a startling turnaround



MORE WINGS: CEO Dastburg has revived employee morale at Northwest

At four in the morning on July 6, 1993, the future of Northwest Airlines Inc. could not have looked worse. Burdened with debt from a \$3.6 billion leveraged buyout and battered by the recession, the airline, based in Eagan, Minn., was unable to meet a \$1 billion debt payment. Lenders refused to budge unless employees took big pay cuts, but negotiations with unions were deadlocked. Northwest's attorneys worked through the night, putting finishing touches on a Chapter 11 filing. They had an 8 a.m. appointment with a Delaware judge.

But the bankruptcy filing never occurred. As the sun rose, Northwest's unions finally approved pay cuts totaling \$886 million in exchange for 30% ownership. When lenders agreed to reschedule \$1.7 billion in debt payments until 1997, CEO John H. Das-

burg won the breathing room he needed.

He has certainly made the most of it. Just one year later, Northwest sees little but blue skies ahead. After chalking up first-half operating earnings of \$328.3 million on revenues of \$4.4 billion, Northwest has emerged as America's most profitable major carrier. Operat-



AL CHECCHI

ing margins for the 12 months ended in June hit 7.3%, well above the 4.9% earned by American Airlines Inc. and the 3.2% turned in at United Airlines Inc.

The 11th-hour bargaining to

avoid bankruptcy is only part of the story. Since early 1992, a new management team led by CEO Dastburg has been steadily shrinking Northwest. Defying conventional industry wisdom that airlines needed to be big to spread costs—a strategy backed by Los Angeles investors Alfred A. Checchi and Gary L. Wilson, the aggressive financiers who took over Northwest in 1989—Dastburg has pared the line's routes down to a profitable core. Now, costs have shrunk, service has improved, and employee morale is up. While the revival could be threatened if a low-cost rival pushes onto its turf, for now Northwest is flying through one of the strongest turnarounds recently seen in the troubled industry.

RAGING WARS. A second-tier carrier with a poor reputation for service, Northwest was purchased by Wilson and Checchi in one of the last big LBOs before the recession hit. Although the airline groaned under heavy debt, the new owners rapidly expanded in the U.S. and Asia. But other major carriers were expanding, too, and fare wars raged. By 1992, cheap tickets, recession, and higher fuel prices decimated industry profits. Northwest, the nation's fourth-largest carrier, lost \$1.8 billion from 1990 through 1993.

When Dastburg took over as CEO in late 1990, he began with a hard look at Northwest's cost structure. As he tells it now, the problem was blindingly obvious: "We were losing money because we were flying places where we were losing money." Dastburg, an accountant who came from Marriott Corp., quickly closed smaller hubs in Milwaukee, Washington, and Seoul, Korea. He eliminated north-south routes on both coasts and



GARY WILSON

Key to Northwest's recovery has been the abandonment of unprofitable routes and a successful alliance with KLM Royal Dutch

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abandoned transcontinental flying. Instead, Dasburg recentered Northwest on hubs in Minneapolis, Detroit, and Memphis, where it faces little competition. He fortified those cities, along with a strong Tokyo hub, with additional aircraft, more flights, and marketing clout.

And while other U.S. airlines are taking a beating going it alone in Europe, Northwest's successful alliance with KLM Royal Dutch Airlines is helping it expand across the Atlantic.

Northwest and KLM have been able to coordinate pricing and service; in February, the two jointly introduced "World Business Class" service. Northwest now flies 2,800 seats to Amsterdam a week, up from 870 in 1993.

"A HARD PENCIL." Such moves have gone a long way to shore up Northwest's financial condition. According to airline consultants Avitas Inc., Northwest's costs on domestic routes, at 8.8¢ per available seat mile (ASM), now rank lowest among major carriers; only low-fare specialist Southwest Airlines Co., at 7.3¢, does better. But with revenues of 10.5¢ per ASM easily beating rivals, Northwest's profits per ASM top the industry's. Revenues for fiscal 1994

should hit \$9 billion, up 4.4% from \$8.6 billion in 1993, while analyst Julius Maludis of Salomon Brothers Inc. expects operating earnings of \$500 million, up 83% from 1993's \$272.4 million. "Northwest is doing very well; they've taken a hard pencil to the whole system," says John Pincavage, director of research for Washington consultants the Transportation Group. Although skeptical when Dasburg first took over, Pincavage now says: "Every time I'm with him, I'm more impressed."

For now, Northwest's liquidity problems also appear under control. A March stock offering returned the carrier to public ownership and raised \$260 million, which paid down part of its heavy debt. Although long-term debt still stands at \$4.2 billion, the \$1.7 billion payment due in 1997 was cut to \$946 million, and may be almost paid off by early 1995. "I don't have a cash-flow issue anymore," boasts Dasburg.

But while Northwest has pulled out of its downdraft, risks of a long-term stall remain. In August, 1996, employee wages snap back to slightly higher than pre-

cutback levels. That will boost Northwest's costs when United, Delta, and American, which is now negotiating wage cuts with its unions, will likely have lowered theirs. Northwest's aging fleet of 110 DC9-30s also needs costly refurbishing to meet federal noise-reduction requirements, and the airline will eventually have to replace its older planes. And while the debt burden has eased, the rescheduling upped debt pay-

Northwest's New Strategy...

ROUTES Northwest has closed money-losing hubs such as Milwaukee and Washington and expanded flights from profitable ones in Minneapolis, Memphis, and Detroit. It has also revamped foreign routes, adding flights to Tokyo and dropping Seoul.

FARES Has recentered on domestic routes with few rivals, so avoids discount competition. By focusing on routes longer than 750 miles, it has steered clear of low-cost, short-haul competitors, while limiting fare promotions to just a few days.

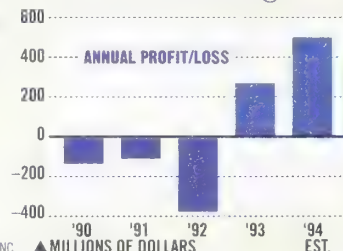
SERVICE On-time performance now beats all major carriers. To attract more high-paying passengers, Northwest has upgraded business-class service with improved food, more legroom between seats, and personal video terminals.

...And Lower Costs...

	DOMESTIC COST PER AVAILABLE SEAT MILE (IN CENTS)	
	'93 2Q	'94 2Q
SOUTHWEST	7.3	7.3
NORTHWEST	8.9	8.8
UNITED	8.7	9.0
AMERICAN	8.9	9.1
DELTA	9.3	10.7

DATA: COMPANY REPORTS, AVITAS INC., SALOMON BROTHERS INC.

...Lift Earnings



ments due after 1998 to \$2 billion. A recession or hike in fuel prices could send Northwest into another tailspin.

Thanks to Dasburg, Northwest does have improved employee morale on its side. Many workers, who felt coerced into the pay concessions, were bitter, and relations between the company's co-owners and its unions had soured. But the deal also cut Checchi's and Wilson's equity stake to below 25%, and well before last year's liquidity crisis, the two co-vice-chairmen had stepped back from day-to-day operations. Although still board members, neither has a hand in strategy. Since August, Wilson has removed himself from company affairs,

An employee suggestion plan yielded \$100 million in savings or added revenue

pending an internal review of a possible minor drug charge, since dropped.

Now, morale appears better. "I've got a lot of people who are really positive right now. A lot of pride is coming back," says Manuel Barbosa, one of Northwest's lead mechanics. Adds pilot Jason W. "We're a lot better off than I think we'd be at this point." Dasburg meets regularly with groups of union employees and holds a monthly "Dial-

phone-in session to field suggestions and criticisms. Worker involvement is paying off. A 1992 employee suggestion program has yielded \$100 million in savings and extra revenues.

Even with lower fares and more productive employees, though, Northwest remains vulnerable to a invasion of low-cost carriers. Because of its dominant position in business markets such as Minneapolis-St. Paul, Northwest is able to keep its fares high. In 75% of all Minneapolis flights, for example, it so fare wars. Instead of offering discounts, Northwest offers three-day sales to top off loads without giving away seats it can sell at higher prices.

RIVALS COMING? All that could change if Southern

or another low-cost specialist turns up Northwest's backyard. So far, quick-turn airlines have favored routes shorter than 750 miles in densely populated areas, while Northwest mostly flies longer routes, many in sparsely populated areas. But few industry experts think Delta's Atlanta hub was vulnerable, and now low-cost ValuJet Inc. is eating away at its routes. "It's hard to imagine that a ValuJet type of competitor would not meet some degree of success [against Northwest]," says ValuJet President Lewis Jordan. "I suspect there are destinations in and out of hubs that are attractive."

Northwest executives, many of whom came from other troubled carriers, say they aren't complacent. "We're engaged in a thrilling trip down a white-water river. The last direction is no guarantee of success, and it will be likely to change forever," says Michael E. Levine, Northwest's marketing head. With that attitude, Northwest may be able to sail smartly into the 21st century.

By Susan Chandler in Eagan, Minn.
with David Greising in Atlanta

The *highway*
is open.

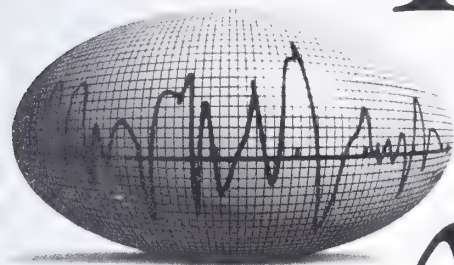


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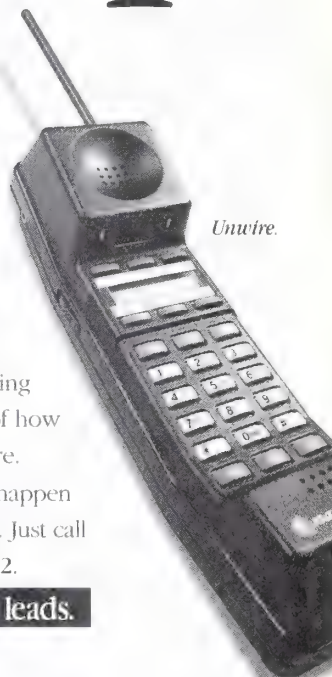
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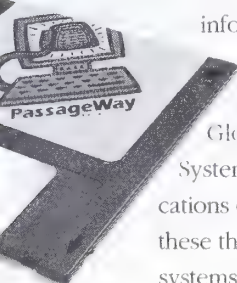
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AN INSIDE LOOK AT CALPERS' BOARDROOM REPORT CARD

The huge investor rates the boards of the 200 biggest companies in its portfolio

For 200 top chief executives, the challenge was about as welcome as an audit notice from the Internal Revenue Service. But there it was: a letter dated May 12 from the California Public Employees' Retirement System (CalPERS), the nation's biggest activist investor, asking them to lift the corporate veil on their boardroom practices. Specifically, CalPERS wanted to know how the biggest companies in its portfolio measured up against 28 provocative guidelines issued last spring by General Motors Corp. GM's six-page document put in writing many precepts boards should be following, but often aren't: having independent directors nominate new members, giving directors access to all top managers, scheduling private meetings of outside directors, and the like.

LIGHT MAILBAG. And how did the recipients of the missive react? Responses ran the gamut from A to Z—or, as CalPERS decided to put it, from A-plus to F. CalPERS General Counsel Richard H. Koppes assigned the grades—revealed here to the companies and the public. **BUSINESS WEEK** was also made privy to several response letters. Beyond the ratings, the exercise provides a unique window on America's boards, many in the throes of change, and is an indication of how companies treat shareholders.



A+ IBM's Gerstner stressed board independence



F+ For American Airlines' Crandall, silence hurt



F+ Gannett's Curley gave CalPERS the brush-off

By Oct. 4, with 41 companies still ignoring CalPERS altogether (meriting an F), just 14 companies—including Chevron, IBM, J. C. Penney, and Kmart—had won an A-plus. At these companies, management and directors had discussed the GM guidelines, most prompted by the CalPERS letter, and each chairman had written to CalPERS with a copy of the company's own, usually stellar, governance practices. An additional 31—Alcoa, Bristol-Myers Squibb, Honeywell, Salomon, Sara Lee, and Texaco among them—won an A. They sent CalPERS their board guidelines, often comparing them point by point with GM's. But unlike the A-plus companies, they didn't say if the board was involved in a review.

At the other end of the spectrum, American International Group, CBS, Bankers Trust, The Limited, MCI Communications, and Raytheon made the list of the F-rated incommunicado com-

panies. Only slightly better are the pluses—DuPont, Johnson & Johnson, Ralston Purina, Gannett, United Technologies, American Airlines, and other companies that replied with a brush-off—a hint to CalPERS to mind its own business. These companies generally saw no need to formalize board practices. "We are of the view that one set of guidelines are appropriate for all corporations," wrote Peter S. Curley, J&J secretary. "We are thus confident that our positions on various corporate governance issues are suitable." **DOG ATE IT?** Gannett Co. General Counsel Thomas L. Chapple, writing for John Curley, was equally curt: "We've already seen a copy of the General Motors' guidelines; however Gannett's board has not adopted these or any other list of formal guidelines concerning how it will conduct itself." Ralston Purina, meanwhile, admitted that a [CalPERS] letter was received but

Who Made the Grade? As responses to CalPERS' governance challenge came in—or didn't—the huge pension fund graded the companies based on how and whether they used the opportunity to evaluate their own boardroom practices. Here is a sampling of results:

A+
BAYTON HUDSON
EXXON
MERCK
TIME WARNER

A
CAMPBELL SOUP
CHRYSLER
EASTMAN KODAK
GENERAL MILLS

B
BANK AMERICA
ITT
MONSANTO
SEARS ROEBUCK

C
AT&T
GENERAL ELECTRIC
MOTOROLA
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F+, F
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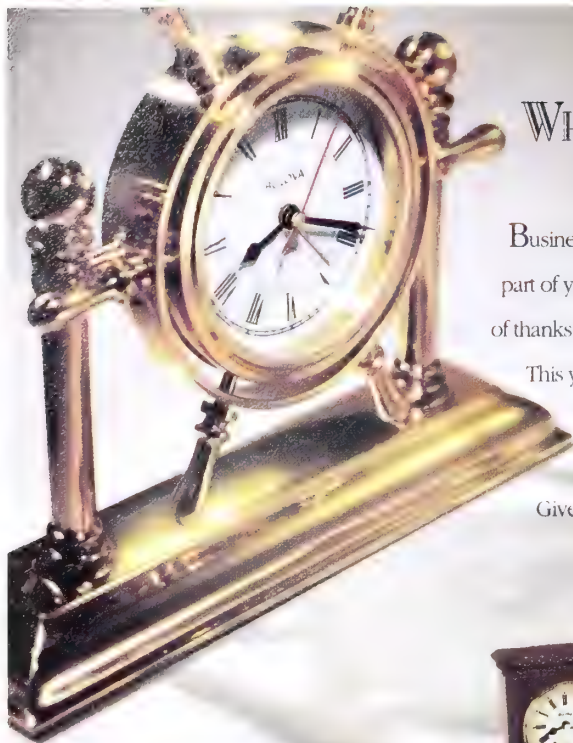
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not clear where it was routed." Rastor General Counsel James M. Neville said that its board agrees with many of the guidelines but "does not feel a formal resolution is appropriate or necessary."

Koppes, who inherited the job when former CalPERS CEO Dale M. Larson left the \$80 billion pension fund in June, readily admits that the grade he gave are impressionistic. Judging by the letters BUSINESS WEEK saw, there's sometimes little difference between "brush-off" F and a D, a category for those that "missed the point." Less from the D companies usually express satisfaction with their own practices, which they didn't detail. As for the companies, which sent a minimal list of their practices and said board review was either possible or scheduled for some future time, and the C companies, which recognized governance as an issue that might be reviewed by the board, CalPERS is seeking more information.

From the outset, CalPERS made it clear that it wasn't trying to force all companies to adopt the GM practices wholesale. It merely wanted boards to think about how they operate. "We want to get directors to be part of a process to look at governance," Koppes says. That's what happened at Boeing, Citicorp, Corning, Emerson Electric, and IBM. Warner, among others: Directors stepped down and reviewed GM's practices. **MANNERS COUNT.** CalPERS' goal, though, skewed some grades; they reflect the completeness of the reply and the board's involvement more than the quality of boardroom practices. By conducting a review and outlining its practices, for example, Corning won an A, even though it follows some practices that are anathema to governance experts—such as asking the chairman/chief executive to chair the nominating committee and to attend an annual confab of outside directors.

It comes as no shock that many of the best replies came from companies that, like General Motors, have undergone upheavals instigated by directors, at least partly prompted by shareholders. Change is readily apparent at IBM, where in early 1993 embattled CEO John F. Akers was replaced by Lou Gerstner Jr. Gerstner's three-page letter to CalPERS outlined the duties of a Board of Directors & Corporate Governance Committee, which reviewed the GM practices in June. And he told of other procedures, such as regular meetings of outside directors and a detailed annual review of their continued independence from the company. Hence, IBM's A-plus.

Eastman Kodak Co., too, revised its board practices after directors dismissed

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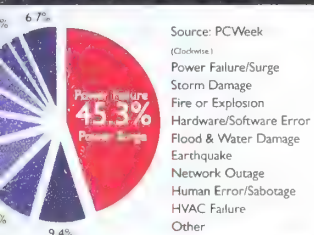
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Fire or Explosion
Hardware/Software Error
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Network Outage
Human Error/Sabotage
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Other

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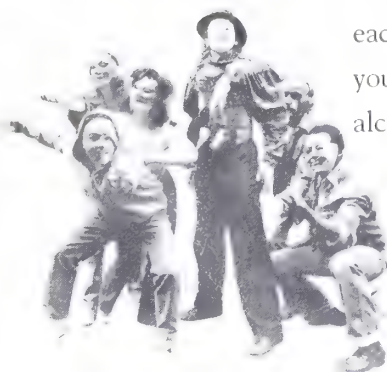
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CEO Kay R. Whitmore in 1993 and hired George M. C. Fisher to replace him. Kodak, which won an A, has not adopted formal governance guidelines à la GM but it rewrote the charters of board committees. Outside directors now convene sessions on their own, and several have met with shareholders. American Express Co., whose board replaced James D. Robinson III with Harvey Golub in 1993 after a showdown with shareholders, won an A with a new governance

CalPERS is already using its report card to target lame boards for proxy action

ance statement that, Golub writes, "seeks to underscore board independence." Among its points: a new committee on directors to develop criteria for nominees and select them, and a provision that outside directors may resign privately whenever they want.

What is surprising, given CalPERS' reputation as a boardroom activist, is the number of companies that ignored its first letter asked for response by Aug. 1, but fewer than half of the 100 companies had replied by the first week in August. It was only after Kopeck wrote the laggards another letter—warning that survey results would be made public—that "the responses rolled in," he says.

If that weren't incentive enough, companies got a push on Aug. 4 when International Paper Co. Chairman John A. Georges, who also chairs the Business Roundtable Corporate Governance Task Force, wrote to members. Noting that CalPERS was likely to publicize these responses, Georges asked companies to copy the Roundtable on them so it could reply to follow-up inquiries. IP Executive Vice-President James Melican, however, says Georges could not comment on the topic until after the Roundtable policy committee meets in November.

CalPERS has already put the responses to good use. They helped the fund make decisions about which 10 poorly performing companies (still undisclosed) to target for next year's proxy season. One F-plus company landed on the list purely because of its response. Meanwhile, CalPERS is set to send a new wave of letters, to the 100 next-biggest companies in its portfolio.

By Judith H. Dobrzynski in New York

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DRUGMAKERS ARE DISCOVERING THE HIGH COST OF CUTTING COSTS

Pressed from all sides, they're narrowing their R&D down to a search for blockbusters

When Dr. Leon E. Rosenberg was contemplating his move from dean of the Yale School of Medicine to head of research and development at Bristol-Myers Squibb three years ago, the pharmaceutical industry looked like research nirvana. "Research and development funding was increasing at double digits," he recalls. There were 4,000 scientists and technicians at the company's lavish research institute in Princeton, N.J., when Rosenberg came on board—and the plan was for

drug discovery programs—and slashed actual drug development projects by one-third. Among the casualties were a new antibiotic and a cholesterol-reducing drug. "That is focus," says Rosenberg. "We are making critical go or no-go decisions on everything."

NO ALSO-RANS. Throughout the drug industry, this change in climate is putting a new premium on innovation—and spurring a profound shift in research strategies. For decades, drugmakers made lush profits churning out modest

into the marketplace with a drug—not first, a very fast second," says Rosenberg. "The fourth or fifth drug is going to give us a decent return."

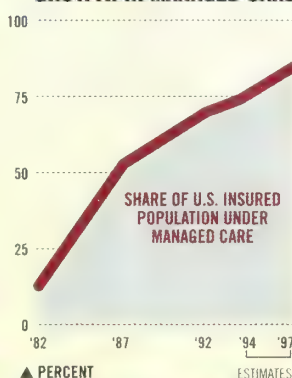
Drugmakers who can't turn out selling new drugs may find themselves forced into mergers or acquisition to sustain growth or fill out their product lists. A shortfall in big new medicine in the near term was one reason Medco spent \$6.6 billion to acquire the distributor Medco Containment Services. A sluggish pipeline played a role in SmithKline Beecham's purchase of Diversi-

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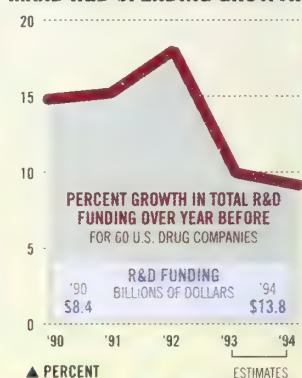
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that number to soon top 5,000.

That, however, was before the sharp rise of managed care and the accompanying tectonic shifts that have rocked drugmakers. Suddenly, price competition has come to an industry long immune to the pressures that previously hit every other part of the economy. And that "has had an extraordinary impact on every piece of our institute," says Rosenberg. "It has required a huge reassessment of our mission and how to carry it out." Since 1991, Bristol-Myers Squibb has eliminated 50% of its basic

improvements in existing products. But the rise of managed care—with its skin-flint pharmacies and HMO buyers who pit me-too drugs against one another to drive down prices—has shrunk profits for nearly all but the most novel treatments. As the fourth cholesterol-lowering medicine on the market, Sandoz's Lescol, introduced last spring, sells for half as much as industry-leader Mevacor from Merck & Co. Pfizer's Zoloft and SmithKline Beecham's Paxil sell for 15% less than the drug they imitate—Eli Lilly's Prozac. "We've got to be the first

Kline Beecham's purchase of Diversi-Pharmaceutical Services and Lilly's proposed acquisition of the PCS pharmacy services unit of McKesson Co. And more recently, American Home Products sought to pump up its product lines by buying American Cyanamid Co.

The race to be first on the market has always been a marathon: It can take years or more to move from a lab scientist's first vague notion to an approved drug. But today there are more obstacles than ever. Researchers are now wrestling with the likes of AIDS,

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Alzheimer's, and stroke, ailments far more daunting than the ulcer and cholesterol problems that have given rise to such top-selling treatments as \$1.3 billion cholesterol-reducer Mevacor and Glaxo Holdings PLC's \$3.5 billion anti-ulcer remedy Zantac, the world's top-selling drug.

Beyond that, the cost of testing is soaring as risk-averse regulators demand more stringent studies. To produce data for regulators worldwide, drugmakers now conduct an average of 60 clinical tri-

Unless the industry produces some miracles, that could be the start of a downward spiral. R&D spending by major U.S. drugmakers grew an estimated 9.3% this year, down from an annual average of 16.2% from 1980 to 1992, according to PHRMA. The trend could worsen if blockbusters—drugs that reap \$1 billion in annual sales—get scarcer, as some analysts anticipate. The number of blockbusters will drop from 21 today to just 17 by the year 2000, estimates Lehman Brothers Inc.



SCHERING-PLOUGH'S PICKETT: Concerned that a narrow R&D focus can backfire

als for each new drug, according to a study from the Pharmaceutical Research & Manufacturers of America (PHRMA). And the number of patients now runs about 3,600, up from 1,600 just 15 years ago. Overall, the congressional Office of Technology Assessment figures it now costs an average \$359 million to bring a drug to market—including overhead and the cost of projects that don't pan out. Even as the need for innovation intensifies, moreover, price discounting is cooling the industry's once-torrid sales. This year, they will rise only about 7%, to \$84.8 billion, vs. a nearly 18% rise just five years ago (chart, page 204).

Partly, that's because major drugs with combined yearly sales of \$10 billion will slip off patent over the next few years to face new competition from cheaper generics. But the main reason is that many drugmakers have come up short in the labs. "A number of companies are suffering from not having exciting drugs in the pipeline," says Dr. Louis Lasagna, dean of the Sackler School at Tufts University and an expert on drug development. Some scientists say the shortfall is a natural lull after the highly productive 1980s. Others blame the industry's early resistance to biotechnology, where much of the

leading-edge academic science was focused in the past 15 years. In any case, many drugmakers staffed their labs and chose their projects mainly to make low-risk improvements to existing drugs—because that was where the easy money was. Top-seller Zantac, for example, is a me-too version of SmithKline's breakthrough Tagamet.

Now, however, those that want to survive will have to do better. And for many drugmakers that means sharpening the focus of R&D. At Eli Lilly & Co.'s sprawling R&D center in Indianapolis, research chief Dr. August M. Watanabe is pushing to make his scientists more productive by killing projects that show little promise or that are behind competitors'. Last year, Watanabe, a cardiologist, phased out hypertension research, slashed a program in the well-tilled pulmonary field and cut back an unproductive virology program. Now, Lilly scientists are focusing on such wide-open areas as central nervous system ailments and cancer. "We're trying to work on unmet medical needs, the areas that are hardest to treat," says Watanabe.

FOLK REMEDIES. Lilly isn't alone. Zeca Group PLC, the British drug spinoff of Imperial Chemical Industries, now limits its researchers to 6 therapeutic areas, down from 13 a decade ago. And where 2 years ago researchers at Switzerland's Ciba-Geigy had 70 compounds under investigation, they've pared the list by half. "You have to be very careful about what you pick to work on," says Dr. Paul A. Friedmann, president of the research labs at Pont Merck Pharmaceutical Co.

Nearly as unprecedented at major drugmakers is a rising desire to look beyond their own labs—and taken partners such as biotech mavericks, smaller drug companies, and academic researchers. Dr. Jurgen Drews, president of international R&D at Roche Holding Ltd., tells his managers that "the responsibility is not to make the best of what they have but to get what's available the world over." Even Pfizer Inc., perhaps the healthiest major drugmaker, with three new potential billion-dollar sellers already on the market, is licensing more new drugs from outside developers. These include a potential treatment for both osteoporosis and breast cancer from a small German company. "No matter how big an R&D budget you have, you can't manage it internally," adds George Poste, research chief at SmithKline.

Some drugmakers are going far afield. Among Lilly's 20 collaborative ventures is a deal with Shaman Pharmaceuticals



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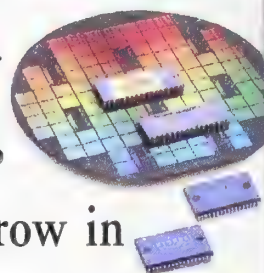
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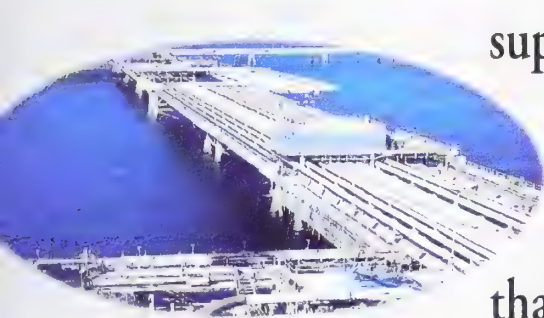
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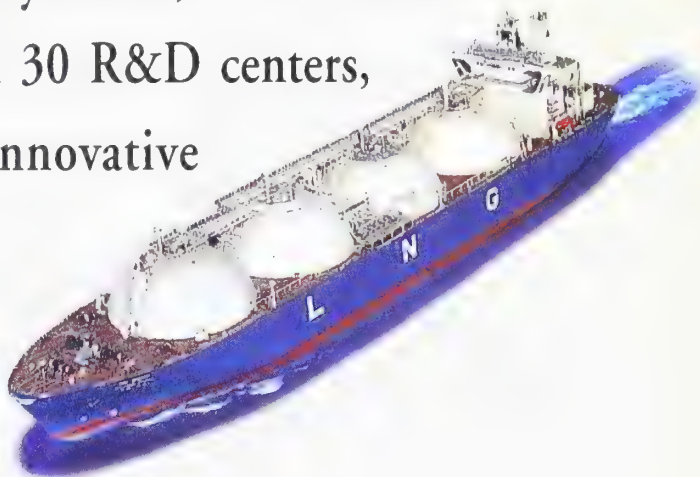
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Inc., a South San Francisco company whose investigators comb the world's rain forests in search of folk remedies. "They take the plants found by medicine men or witch doctors and try to identify what is the active ingredient," says Watanabe. Lilly scientists hope that they will find potent antifungal agents this way.

The major drugmakers are now increasingly turning to biotech, as well. In 1990, Switzerland-based Roche placed the industry's biggest bet so far by paying \$2.1 billion for a 60% stake in Genentech, later boosting the stake to 65%. The prize at Genentech: its rich product pipeline and two profitable drugs, human growth hormone and TPA, for heart attacks. In just a few years, analysts say, erythropoietin (EPO), the anemia and dialysis drug jointly developed by Johnson & Johnson and biotech innovator Amgen Inc., may become the world's best-selling medicine.

The big drugmakers have to pick their partners and projects carefully, however, since cutting-edge efforts have high failure rates. Lilly paid \$100 million for the rights to a septic-shock treatment, Centoxin, that ultimately fizzled for its biotech developer, Centocor Inc. in Malvern, Pa. As a consolation prize, Lilly now has the rights to Centocor's ReoPro, a forthcoming medicine to prevent blood clots that can occur after angioplasty. **MOVING MOLECULES.** Besides striking such alliances, mainstream drugmakers are also doing more biotech research in house. If all the biotech scientists at Bristol-Myers Squibb were counted as a unit, "we'd be the second-biggest biotech company in the world," claims R&D chief Rosenberg. But these are high-risk efforts, too. Bristol scientists are now cooling on a much-ballyhooed cancer treatment they developed that hitched traditional chemicals to monoclonal antibodies to produce a more pre-

cisely targeted medicine. The drug worked well in animals but hasn't yet so yet in people.

Drugmakers now have far better tools to speed their searches for promising compounds that can stop diseases at the molecular level. At DuPont Merck, many other drugmakers' labs, scientists don specialized glasses to view brightly colored three-dimensional models of proteins involved in everything from heart to stroke. They manipulate the images to tailor-make molecules that can kill disease-causing cells from reproduction. Such modeling techniques, together with lab robots that mix chemicals and release cells round the clock to find active drugs, are vastly simplifying once cumbersome screening efforts.

Still, drug discovery remains a painstaking and seldom successful task. For every 5,000 compounds researchers test, at perhaps one becomes a marketable drug, according to PHRMA estimates. "It's not at all unusual for medical chemists to spend entire careers in the pharmaceutical industry and never have their name associated with a marketable drug," says Stephen L. Brenner, senior director of physical sciences at DuPont Merck.

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TO BUILD THE COMPANY DOESN'T MEAN YOU
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DR. FRIEDMAN: "You have to be very careful about what you pick to work on"

may become even truer as regulators become more picky. While the Food and Drug Administration has been under pressure to shorten approval times, it is growing reluctant to O.K. drugs based just on demonstrations of clinical effect, such as lowering blood pressure or cholesterol. Regulators accept such "surrogate markers" of effectiveness when cholesterol-reducers

debuted in the mid-1980s. But they're beginning to require stronger proof in new applications for such drugs. The FDA wants evidence that these reduce heart attacks.

Some researchers lament that tighter regulation limits chances for unexpected breakthroughs. In the 1950s, a Swiss psychiatrist was disappointed that an experimental Ciba-Geigy drug

didn't work on schizophrenics, but he subsequently found that it worked on people suffering depression. The company broadened its clinical studies and had the drug, Tofranil, on the market in three years. Today's stringent procedures would make it harder to shift directions so quickly. "The regulation of clinical trials has become such that there isn't much room for clinical serendipity anymore," complains Dr. Solomon H. Snyder, director of neuroscience at Johns Hopkins University's School of Medicine.

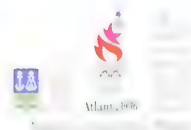
TAKING NO CHANCES. Indeed, the drugmakers will have to be careful that their new, tightly focused R&D strategy doesn't backfire. "You must give people the opportunity in the laboratory to use their own judgments and instincts, and the serendipity will come," says Cecil B. Pickett, executive vice-president at Schering-Plough's research institute. Drugmakers who don't give their scientists that kind of chance—and who don't turn out big new medicines—may find themselves on the short end of a merger with a rival who sees innovation as the only sure ticket to success.

By Joseph Weber in Philadelphia, with John Carey in Washington, Joan O'C. Hamilton in San Francisco, and Julia Flynn in London



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INTELLECTUAL PROPERTY

HALTING HIGHWAY ROBBERY ON THE INTERNET

It will take crafty codes to curb theft of copyright material

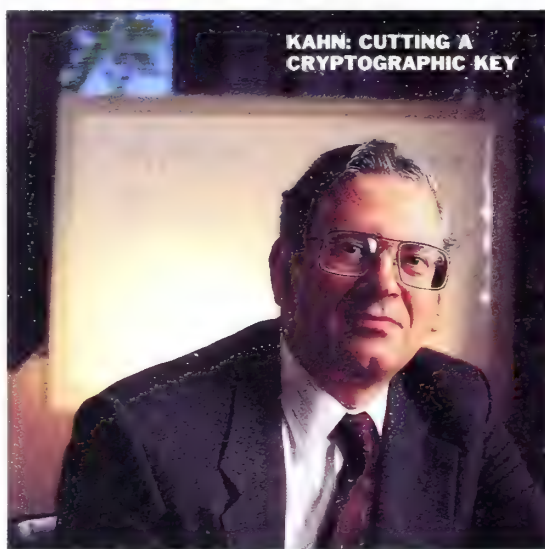
Given the explosive growth of the Internet, data jockeys on the Information Superhighway should soon be able to retrieve almost anything stored on a computer anywhere. Or will they? Many experts foresee an era where most of the world's accumulated knowledge will be available via the Internet. But such visions could founder on a nettlesome practicality: Unless the creators of information "have confidence that their products are not going to be expropriated," the wired world could develop a short circuit, says Bruce A. Lehman, commissioner of the U. S. Patent & Trademark Office.

Today, such assurance is sorely lacking. The scale of potential copyright violations in a digital age vastly surpasses the damage that can be inflicted with a photocopy machine. Anyone with a computer can make and distribute countless copies of anything digital, be it a book, a TV or computer program, or a piece of music. Even worse, the digital version can be sent to a bulletin board system (BBS) for "downloading" by anyone with a modem. The Recording Industry Association of America (RIAA) has spotted several bulletin boards where copyright music is freely available. And it worries even more about the Internet, which can distribute documents to millions of people. Remarked RIAA General Counsel David E. Leibowitz during a panel discussion at the June Consumer Electronics Show in Chicago: The Internet "seems uncontrollable."

PROTOTYPE. Maybe not. Several new research efforts are aimed at curbing copyright violations—and later this month, the first field test of a prototype Electronic Copyright Management System will start at the University of Illinois. The system is being developed by the Corporation for National Research Initiatives (CNRI), a nonprofit outfit in Reston, Va., the Library of Congress, and the Defense Dept.'s Advanced Research Projects Agency (ARPA).

The digital copyright system will use encryption—up to a point. Turning computer files into essentially unbreakable

codes would guarantee protection, of course. But it would also defeat the purpose of on-line information: to make it possible to quickly sift vast storehouses of knowledge. Robert E. Kahn says he has been mulling this dilemma for a decade. "I founded CNRI in 1986 to tackle the things that would foster a cohesive information infrastructure."



ONE SOLUTION A cypher could be hidden in the document, identifying owner and buyer. If the information should leak onto a bulletin board, it would be possible to nail the offending party

Kahn's system will preserve the ability to do on-line searches by automatically generating plain-text descriptions and subject categories when documents are deposited electronically with the Library of Congress before being stored on various computers around the world. It will handle information in any form, says John Garrett, CNRI's director of information resources. "So you'll deposit one complete digital object" when registering a multimedia presentation.

To buy protected information, a customer would purchase a cryptographic

key to decode the document. The key could depend on what the buyer was given from one-time personal rights to a restricted license. "We're still working on this," says Garrett. When it's finished next spring, a cypher could be hidden in the document, identifying its owner as the buyer. Thus, if the information should leak onto a BBS, it would be possible to nail the offending party. "We can even imagine an embedded cypher that contains a program to prevent unauthorized use," he adds. If a person purchases one-time rights, the document will turn into gibberish when transmitted via electronic mail.

DIGITAL DEBITS. This copyright management system is just a foundation, says Kahn. It has been designed "to encourage diversity" in add-on technology. For example, Carnegie Mellon University will soon unveil the NetBill system developed by computer scientists Douglas Tygar and Marvin Sirbu. One of its goals is to trim transaction costs to a fraction of a cent. This is important, says Tygar, "because we think a lot of electronic information will cost less than \$1." With NetBill, customers will use money they've deposited against future shopping sprees, rather than cash or credit cards.

The University of Illinois will test CNRI's technology as part of a \$24 million, six-year university initiative in digital libraries recently launched by the National Science Foundation, ARPA, and NASA. Last

month, Kahn went to Illinois to give the first major colloquium on the digital copyright system. "My reaction was, 'I'm doing it again,'" says Charles E. Catlett, associate director of Illinois' National Center for Supercomputing Applications and a cryptography expert. Kahn was the chief architect of the ARPANet in the 1970s and the Internet in the 1980s. Since he, perhaps more than any other person, has precipitated the crisis in intellectual property, it's fitting that he should help solve the problem.

By Otis Port in New York



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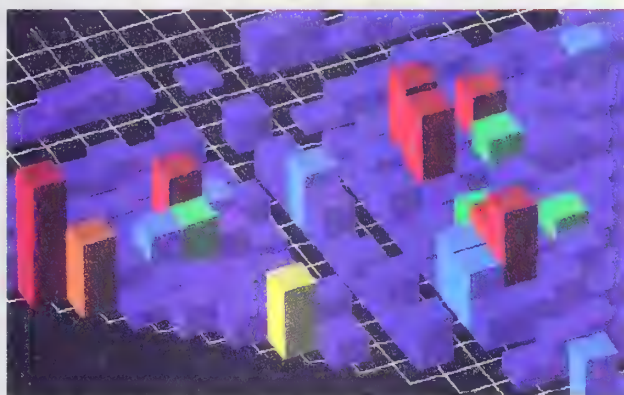
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BY NEIL GROSS

NG: UTERS WITH EYESIGHT

MAN BEINGS, PATTERN
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arts.



A SEARCH FOR CURES IN RANDOM PLACES

RATIONAL DRUG DESIGN, STEP ASIDE: IRRATIONAL DRUG design is here. The idea of this new field is to generate billions of diverse snippets of DNA, RNA, proteins, or other organic molecules at random, then see which do best at, say, fitting into a receptor. Top candidates are reproduced with mutations, and the screening is repeated. It's a sped-up version of natural selection.

The approach is attracting some top biotech brains. In August, a band of research institutions and companies quietly formed the nonprofit Diversity Biotechnology Consortium to further the use of this technique, called molecular diversity, in studying molecular function and treating disease. The consortium's first president is Stuart A. Kauffman, a biochemist at Santa Fe Institute.

The same statistical tools that screen synthetic molecules can be used to study mutating viruses. A team led by Los Alamos National Laboratory—one of the consortium founders—generated the graph above. According to researcher Alan S. Lapedes of Los Alamos, it shows correlations between mutations in different sections of HIV's envelope protein. Tall red bars indicate strong correlations—useful information in designing a vaccine.

THIS DRUG MAY BE A STOP SIGNAL FOR RUNNY NOSES

FOR AN ILLNESS WITH NO cure, the common cold is surprisingly well understood. During a typical infection, large quantities of white blood cells known as polymorphonuclear leukocytes migrate to the mucous membrane in the nose. That, according to researcher Ronald B. Turner at the Medical University of South Carolina in Charleston, triggers a cascade of responses from the host—including headaches and fevers.

Blocking the first step in the cascade could avert the whole chain of miseries. Turner discovered that pentoxifylline, a drug prescribed for certain vascular diseases, partially inhibits the production of a protein called Interleukin-8, which the body makes in response to cold virus infections and which seems to attract the white blood cells to the nasal mucosa. If there is no IL-8, Turner reasons, there will be no runny nose. Administered orally, pentoxifylline has no serious side effects, but a nasal spray may be a different matter. Turner hopes to begin human tests by mid-1995.

TUNING INTO A MYSTERY FROM DEEP SPACE

HOW MUCH "DARK MATTER" is hidden in outer space? It's one of the universe's deepest mysteries. Dark matter can't be observed, astrophysicists theorize, because it consists mainly of atomic particles unknown on earth. And yet, current theories concerning the creation of elements and the formation of galaxies hinge on the matter's existence.

The hunt for this missing matter may soon get a boost. Physicists at two

French universities, Paris-South and Pierre & Marie Curie, are working on a new tool for "listening" to the collisions of dark and ordinary matter. Called a saser, it works on the same principle as a laser, but it amplifies sound instead of light. To prevent the saser from picking up

ambient sounds on earth, re-

search team leaders Jean-Yves Prieur and Martin Devaud say the 2-cm-long rod of pure silica must be cooled almost to absolute zero (−459.7°F). Now, the saser is four times as sensitive as the sound amplifiers used in physics labs. Next, by adding some special chips, the instrument could become a true match for the music of the spheres.



TWILIGHT OF A BANK BONANZA

Selling services looked good until banks began price wars

Does commercial banking have a future? For years, banks' core lending-and-deposit business has been seriously eroded by nonbank competitors. Bankers now feel they have identified a Holy Grail that will be the key to their salvation. They are aggressively pursuing such businesses as mutual funds, cash management, and investment banking that produce fee income with, they hope, high profit margins.

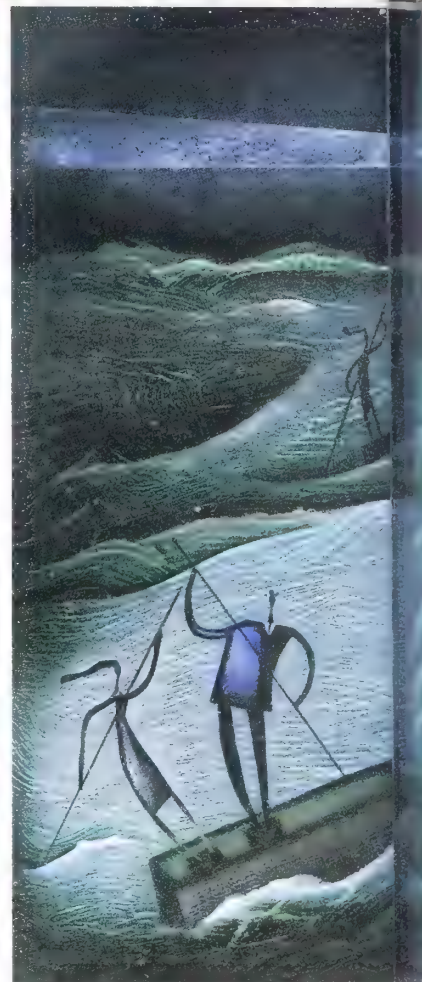
That hope may be empty. Many of the biggest fee businesses are becoming fiercely competitive as banks push into already-crowded markets. Treacherous capital markets and rising interest rates make matters worse. True, fee income is still healthy at many banks. But increasingly, banks grabbing at fee income will find it less a Holy Grail than a will-o'-the-wisp. "Banks are saying, 'We want fee income, we want fee income,' but they're discovering it's no panacea," says Seamus P. McMahon, a vice president at Booz, Allen & Hamilton Inc., who specializes in consumer banking.

Most banks are still raking in handsome profits, thanks to unusually wide spreads between funding costs and loan and bond rates. Over time, though, those spreads will shrink. And few banks, as it happens, are making big strides in inventing proprietary products where they could set prices. If fee businesses remain intensely competitive, banks may be forced to slash costs, develop new businesses, and reinvent themselves drastically to survive.

The appeal of fee income is clear: In contrast to lending, where bankers must always worry about getting their money back, fees are relatively low-risk. But the main problem with fee businesses is that many of them are commodities. In the businesses banks are focusing on, customers tend to grab the lowest possible price. "All the banks rush into a business when they see high margins," says Livia S. Asher, a banking analyst at Merrill, Lynch & Co. "Unfortunately, they then compete on price and reduce the profitability."

STRAPPED FOR CASH. That process is well under way. Consider cash management and custody, the back-office businesses of processing transactions and transporting funds. Cash management is rapidly becoming a commodity. A new study by consultant Ernst & Young predicts that cash-management revenues will grow just 6.25% in 1994, down from 7% in 1993, and that revenue growth for the top managers will grow just 4.5%.

A few banks with large market shares still book respectable profits. At Chase Manhattan Corp., for example, Deborah L. Talbot, executive vice-president in charge of cash management, says the bank is expanding its business overseas, where margins are wider. But clients' losses in this year's difficult global markets have constrained growth in funds under management, which is further constraining all cash managers' fee income.



The custody business is no better. Boston-based State Street Bank & Trust Co. stunned rivals when it bid a fraction of others' offers to get the custody business of the California Public Employees' Retirement System, but such price-cutting is almost routine. What's more, Wall Street firms are making inroads. Morgan Stanley & Co. has quadrupled its custody assets in the last two years, says Managing Director Frederick R. Walsh Jr.

The credit-card business is starting to come under pressure, too. Banks have long enjoyed outsized returns on their credit-card portfolios, in part from credit-card fees. Return on assets (ROA) of 3% has not been uncommon, while net

Fatal Delusion?

How banks' efforts to boost fee income could founder: Most fee generation businesses are becoming hotly competitive and tend to have relatively low profit

CREDIT CARDS

Facing an overcrowded market, some banks are all but giving away the store: rates below 7%, no annual fee, bonuses for transferring balances.

MUTUAL FUNDS

Banks have spent heavily to enter the business. But treacherous markets and intense regulatory scrutiny are making it hard to offset startup costs.

CASH MANAGEMENT

As the service becomes a commodity, banks are putting in ever lower bids for new business. Corporate treasurers are pushing banks to lower fees.

INVESTMENT BANKING

Merger activity is high, but advisory fees are thin, thanks to heavy competition. In trading, difficult markets are making it harder for new players.



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If fee business remains fierce, banks could be forced to slash costs—and even reinvent themselves

der for some of these medium-
issuers [with credit-card receiv-
between \$100 million and \$1 bil-
play the game," he says.
n First Chicago Corp., one of the
t players in the credit-card mar-
feeling the effects of the price
cott P. Marks Jr., an executive
resident and head of the First's
card business, sees the bank add-
credit-card receivables at a healthy
8% for the next several years.
at's slower than past years, and
concedes that in the future cred-
s are "not likely to have the same

growth dynamics."

The same is true for
the mutual-fund busi-
ness. Banks are still
rushing into mutual-
fund sales. But with
stock and bond markets
turning in decidedly
mixed performances,
customers have become
skittish—particularly
customers who are con-
sidering buying funds
at their bank, since
they tend to be rela-
tively conservative in-
vestors. And most

bank-fund operations lack the econo-
mies of scale enjoyed by major non-
bank fund groups. Only the very larg-
est bank mutual-fund operations are
making money day-to-day, says Booz
Allen's McMahon. And "If you count-
ed startup costs and amortized them,
probably none of the bank mutual-fund
operations are profitable."

MONEY, MONEY, MONEY. In search of
higher profits, many banks have been
buying mortgage-banking operations,
elbowing into the business of making
and servicing mortgage loans. But with
interest rates rising, there are far few-

er mortgage loans to be made—and that
means fewer origination fees. Moreover,
mortgage banking is a low-margin com-
modity business where borrowers have
little brand loyalty and shop almost en-
tirely on the basis of price. Banks that
service large mortgage portfolios enjoy
respectable profits. But earnings are
anemic for smaller players that lack
scale economies. Notes Carole S. Berger,
a bank analyst at Salomon Brothers Inc.:
"I wouldn't start a mortgage-banking
operation today."

Even fees for checking accounts are
coming under fire. Consumer advocacy
groups such as the U.S. Public Inter-
est Research Group (USPIRG) and the
Consumer Federation of America are
publishing reports blasting high fees,
and there have even been congression-
al hearings to address the issue. Says
Edmund M. Mierzewski, consumer pro-
gram director at USPIRG: "Banks have
a strategy to increase fee income, and I
don't think it's necessarily fair to consu-
mers." Many banks are now wary of hik-
ing account fees any higher for fear of a
consumer backlash. In June the groups
even asked the Justice Dept. to investi-
gate whether banks are violating anti-
trust laws when they set fees. The Jus-
tice Dept. says only that it is
investigating certain bank practices.

PIECE OF THE PIE. What makes the rush
to fees particularly troubling is that
nonbank rivals are invading banks' core
businesses while the banks are busy
investing in mutual funds and the like.
Merrill Lynch, Lehman Brothers, and
CS First Boston have all hired high-
level commercial bankers to help them
build up lending businesses. These
firms already have a leg up on banks
in providing other forms of financing,
so offering loans as yet another financing
product will likely be a natural for
them—and it will be a natural for their
clients to buy from them instead of
their commercial banker. Jack Yang, a
Merrill director, who moved there from
Chemical Banking Corp. in June, says:
"We have an opportunity to be involved
with a transaction sooner than most
banks because Merrill can take an advi-
sory role."

Certainly, a few fee businesses are
still attractive. Banks selling newer
products such as retirement-plan man-
agement, for example, are seeing
healthy profit growth. And the biggest
players and those with the lowest costs
may be able to withstand much of the
pricing pressure. But most banks chas-
ing fee income would do well to remem-
ber the old adage about free lunches. In
fact, they would be better off making
sure no one is eating theirs.

By Kelley Holland in New York, with
Richard A. Melcher in Chicago



REAL ESTATE

ONCE AGAIN, IT'S REAL ESTATE A-GO-GO

Commercial properties are hot. Maybe a little too hot

When T. Gregory Kraus bid over \$100 million for an upscale shopping mall outside Phoenix last month, he thought the offer was "tremendously aggressive." But he and his pension-fund clients didn't even come close. Another bidder, he was told, bid \$10 million more for the property. "We were just left scratching our heads," he laments.

Hang on to your wallets: Commercial real estate is back. At a rate that was unexpected even a year or two ago, when the real estate market began its comeback, investors are flooding the once-comatose market with dollars. Pension funds are hunting for properties to buy and tiptoeing into the mortgage business. Banks and insurance companies are tripping over themselves to lend to borrowers (chart). Even Hong Kong and Japanese institutions, which were burned in the '80s, are testing the waters.

All of this activity is raising fears of a return of the downside of the good old days—a bidding frenzy that will come back to haunt investors and lenders. "It's too much too fast," warns Carl H. Kane, a managing director at real estate accounting firm Kenneth Leventhal & Co.

With an expanding economy, and with little new construction under way, office, warehouse,

and apartment properties are hauling in the "For Rent" signs. Meanwhile, banks and insurance companies are flush with capital that they want to lend to property owners and buyers.

So even as mortgage rates climb, the spreads on commercial real estate loans—the difference between the rate paid by the borrower and the rate on a Treasury security of comparable maturity—are narrowing. But they remain much wider than spreads on many other fixed-income investments, so it is still an enticing business for lenders. Intense competition is increasingly visible everywhere in real estate, but the biggest impact is in three areas:

■ **REAL ESTATE PRICES.** Signs of warming market prices, and declining vacancies, are everywhere. Apartment buildings in such markets as Atlanta and Austin, Tex., are priced at over 90% of their his-

MALL MANIA: The Fiesta Mall in Mesa, Ariz., was the center of intense bidding.

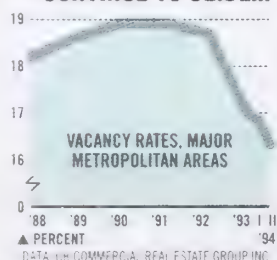
torical highs, up from a low of 60% as recently as 1992 for some markets according to CB Commercial Real Estate Co. Inc. In midtown Manhattan, where vacancy rates climbed from the single digits in the early '80s to an excruciating 17.4% in 1991, the number is now 14.4%—the lowest in four years, according to Cushman & Wakefield.

■ **MORTGAGE LENDING.** Meanwhile, competition is driving down spreads in mortgage-backed securities. Certain properties, such as apartment buildings. That makes it easier for borrowers to find good deals—and tougher for lenders. Just ask G. Abbott Davis, real estate investment officer with the \$40 billion New York State Teachers Retirement System. In April, Davis won a loan to the Fiesta Mall outside Phoenix, offering a rate of 1.3 percentage points over similar treasuries. He says the deal to the real estate arm of Prudential Insurance Co., which lent more than \$60 million at a spread of about 1.5 points. Such cutthroat bidding is paid the course nowadays. "A year ago there just weren't as many people coming to the table," observes Davis.

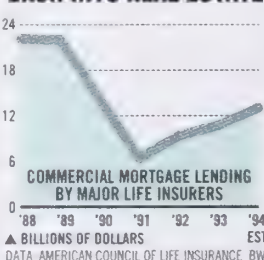
■ **SECURITIZATION.** Nowhere is the scramble for deals keener than in mortgage-backed securities business.

While apartment buildings, to a lesser extent, shopping malls have been the main focus for securitization in the past, dealmakers are now pushing into the office building and hotel sectors. As these properties show signs of recovery, investment bankers are finding it possible to sell securities backed by these assets. So there were no raised eyebrows when Nomura Securities International Inc. earlier this year securitized pools

AS OFFICE VACANCIES CONTINUE TO SLIDE...



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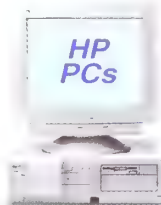
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loans on large properties that included office buildings and hotels.

The market for smaller loans is becoming even more crowded. Such lenders as Bank of America, which set up a unit nine months ago to make commercial real estate loans in the \$1 million to \$7.5 million category, are becoming aggressive competitors. And the number of "conduits"—operations set up by Wall Street firms and other investors to pool and securitize commercial loans usually in the \$1 million to \$15 million range—has doubled in the past year to nearly four dozen, according to Leventhal's Kane.

For many real estate financiers, the market will only get tougher. As property values continue to rise, real estate investment trusts and other acquirers will find cheap deals more difficult to come by. Rising interest rates are already sparking resistance on the part of some borrowers. This less friendly environment makes it likely that some firms will get burned. Conduit operators are predicting a shakeout in that hotly contested business as institutional lenders return and regional banks, such as First Union Corp. and Bank of Boston Corp., dive into the securitization business directly. Already some of the larger Wall Street firms, such as Lehman Brothers Inc. and Bear, Stearns & Co., have approached a number of smaller conduits about buying their loan portfolios—which may not, by themselves, be large enough to support a securitization.

BUILD OR BUY? Real estate professionals warn that as vacancy rates drop to single digits in such hot markets as Salt Lake City and Las Vegas, and prices continue to climb, it may become cheaper to build than to buy. Even without new construction that could disrupt the market's recovery, some loans being made today may prove hazardous for lenders and borrowers alike. "You can get a loan of more than 80% of the value of a property today. Those are risky loans," says Michael L. Evans, who heads Ernst & Young's real estate advisory group.

It's not exactly the crazed '80s—yet. But some experts are worried. S. Michael Lucash, operations chief at Arbor National Commercial Mortgage Corp., says he has seen banks skimping on appraisals and offering below-market interest rates. Seems the memories of the 1980s may have already grown a bit too dim.

By Amy Barrett in Washington, with Russell Mitchell in San Francisco and David Greising in Atlanta

MONEY MARKET FUNDS

PRIME SUSPECT IN THE MONEY-MARKET MURDER

GSC may have dealt Community Bankers the fatal blow



LAPORTE: GSC's owner exploited an apparent loophole in SEC regulations

The collapse of Community Bankers' U. S. Government Money-Market Fund on Sept. 27 was a startling and highly unusual event: the first time a money-market fund dropped below \$1 per share. The apparent reason for the collapse, though, seemed all too familiar: Once again, investment managers had been blinded by their love affair with risky derivatives.

But government and company documents and other sources suggest that there may be more to the story. Many of the exotic securities whose sharp decline in value forced the fund to close down may have come to the fund through a government-securities dealer with a controversial history: Houston-based Government Securities Corp. of Texas, a subsidiary of GSC Group Inc. (BW—

Dec. 6, 1993). GSC of Texas has been target of actions by several state regulators and has been sued by municipal officials who invested in its products. A common thread in these actions is that GSC sold derivative products to unsophisticated municipal officials without spelling out potential pitfalls. Jon Backlund, a former banker who ran Community Assets Management Inc., was the investment adviser to the Government Money-Market Fund, complained in an interview with *American Banker* that he "hired people to manage our money and got involved in a situation where the risks were explained."

GSC Group had a usual relationship with the Government Money-Market Fund. GSC's parent, Citicorp. of Milwaukee, another subsidiary

Community Bankers says GSC let it dally with derivatives but didn't explain the risks

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GSC continued to ply its exotic wares—despite a dubious record. That raises serious regulatory questions

Group, was an adviser to the fund while GSC of Texas, the securities dealer, sold it securities. That creates an incentive for the adviser to favor the dealer's securities. Securities & Exchange Commission rules generally bar transactions between funds and affiliates to avoid self-dealing and other abuses that can harm investors.

The SEC is looking at Community Bankers' management and at whether the fund should have steered clear of the securities that forced the fund's liquidation. When it shut down, 43% of the fund's \$82.2 million in assets were exotic securities such as derivatives, well above the 10% limit on such securities. "These are the kinds of securities that are not appropriate for money funds," SEC Chairman Arthur Levitt Jr. told Congress on Sept. 27. Ninety-four institutional investors, nearly all community banks, stand to lose 6¢ on the dollar of their investments. Mark Elste, president of GSC Capital, declined to comment and referred questions to CAM's Backlund. Backlund declined to respond to interview requests and written questions.

FIRST BLOSSOM. The fund's failure jeopardizes a groundbreaking experiment in investment self-reliance for community banks. It started in 1989, with a consortium of 67 small banks that owned CAM. The banks created several funds, including the institutional fund that went under. The adviser signed up more than 200 community banks in 22 states.

Under CAM's management, the Government Money-Market Fund grew to \$70.7 million in assets by early 1992. Fund records show it did a lot of business with GSC of Texas. Since Community Bankers geared up, GSC has sold the fund more than \$50 million in repurchase agreements, according to fund financial statements. Frank J. Klaus, GSC executive vice-president, confirmed that GSC sold CAM many other securities.

When the Government Money-Market Fund slipped in assets to \$64 million in early 1993, CAM started looking for a subadviser to run the portfolio. GSC Capital of Milwaukee wanted the job, but it apparently perceived a problem. It was controlled by GSC Group. That posed a possible conflict under the SEC's strict rules for affiliate transactions. So Christopher L. LaPorte, who owns GSC Group, reorganized the Milwaukee unit.

In late January, 1993, GSC Group reduced its voting stock in GSC Capital to 4.8% of the voting stock—just under the legal threshold for an affiliate. "We did it to get around the affiliate trading prohibition," confirms Klaus.

In May, 1993, CAM gave the job to GSC Capital, an investment adviser for at least three funds. After the new adviser took over, GSC of Texas traded only with GSC Capital, rather than directly with the fund, Klaus claims. He adds that GSC Group didn't know how GSC Capital allocated the securities it bought among the funds it ran.

But though it held little of the voting stock, GSC Group held a half ownership

A MONEY FUND'S DEMISE

1989 Community Assets Management (CAM), an investment adviser owned by a consortium of small banks, formed a money-market fund. A big supplier of securities to the fund is Government Securities Corp. in Texas, a firm with a history of regulatory problems that is owned by GSC Group.

1992 GSC gets into the business of managing money-market funds by forming GSC Capital. GSC Group has 50% ownership and voting control of the new adviser.

1993 GSC Capital takes over management of the money-market fund from CAM. But there's a hitch: SEC regulations bar fund managers from doing certain business with affiliates. But GSC Group finds an apparent loophole. It reduces its voting stock in GSC Capital to 4.8%—just under the threshold for an affiliate. But GSC Group still owns half the company and 95% of its nonvoting stock.

1994 GSC Capital buys a lot of risky securities from GSC Securities, which may have ended up in the money fund. When the bond market collapses during the spring, the money fund suffers huge losses because of its high percentage of risky securities. On Sept. 27, the money fund is forced into liquidation. About 90 community banks stand to lose 6¢ on the dollar.

DATA BUSINESS WEEK

and controlled 95.2% of the nonvoting stock. In a company newsletter in 1993, GSC Group continued to call GSC Capital an "affiliate." But, says Klaus, "GSC got a legal opinion on file from counsel stating that after the reorganization the unit was independent."

At first, the fund blossomed under GSC Capital. Assets of the Government Money-Market Fund rose to \$126 million by early 1994, and it ranked among top institutional money-market funds returns. Yet that came from an unusually large portfolio of exotic securities called government agency structured notes. The returns on these securities fluctuate by complex formulas tied to changes in interest rates. When rates rose sharply this spring, the securities tanked. GSC Capital, which by then had been renamed Prospect Hill Advisers Inc. following adverse publicity from lawsuits against GSC of Texas, was terminated as adviser on July 31.

HOT ON THE TRAIL. This was not the first time GSC of Texas has been involved in controversy. In 1982, the company was suspended by the Texas Securities Commission for five days for selling securities without registering as a dealer. In 1986, the Tennessee Securities Div. forced the firm to disgorge \$65,000 in profits GSC earned when it was not properly registered in the state. The company settled without admitting or denying guilt. In 1989, it was accused of selling securities without being registered. GSC registered in 1991.

Customers have been hot on the trail, too. The firm was sued in October 1993 by Sandusky and Portage County over derivatives securities that went sour. And the city of Bryan, Tex., filed a lawsuit in August alleging that GSC deliberately misled it about the maturity and rating of derivatives it bought. GSC settled the Sandusky suit and is negotiating to settle the others. In addition, Minnesota lawmakers barred local governments from buying high-risk securities after several counties lost money on investments bought from GSC.

That a firm with GSC of Texas' dubious record was able to continue plying its exotic wares raises serious regulatory questions. Despite the current wave of deregulation, the Community Bankers' debate suggests that mutual-fund regulation, especially rules against self-dealing, ought to be even tighter.

By Michael Schroeder in Washington

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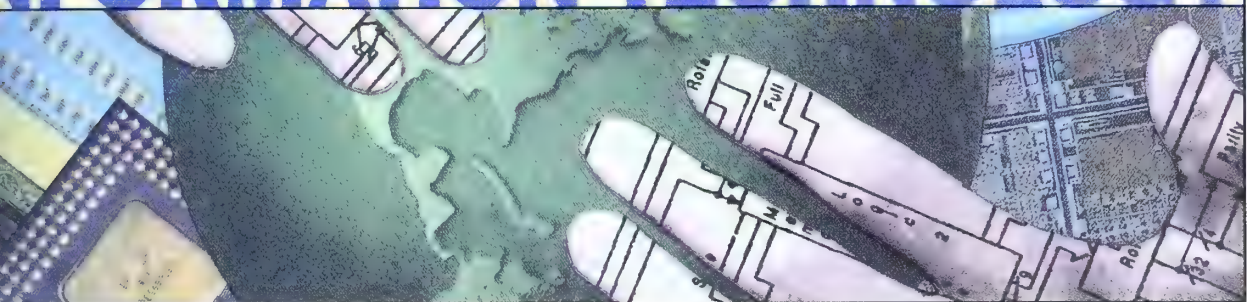


Illustration by Victoria Kann. As seen in BusinessWeek, May 23, 1994 Issue.

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BY JEFFREY M. LADERMAN

NOT YOUR AVERAGE ENERGY PLAY

Investors who have bet on higher natural-gas prices have been sorely disappointed. Spot prices surged over \$3 per thousand cubic feet (MCF) last winter, but now, even with the cold weather approaching, they're down to \$1.70, and shares of companies tied to the natural gas industry have tumbled. Tidewater is no exception. At 21% the Big Board issue is down 15% from a year ago. But money manager Michael A. Steinberg says the slump is an opportunity for a potentially big payoff—a \$50 stock within three years.

Steinberg, whose Steinberg Asset Management holds 1.3 million shares of Tidewater, or 2.4% of shares outstanding, is bullish on natural gas. He's forecasting about \$2.40 per MCF by 1996. But the money manager, who has nearly 10% of his more than \$300 million under management in Tidewater, says the stock will be a winner even with \$2 gas. "If prices go higher sooner, Tidewater will just get to our target faster," says Steinberg.

Nearly 90% of Tidewater's \$522 million in fiscal 1994 revenues came from operating supply boats that ferry pipe

Steinberg says, day rates will climb because there will be fewer boats for hire. "One-third the worldwide fleet was built before 1975, and the average life of a boat is 20 years," he says. New construction virtually stopped in the early 1980s. Steinberg estimates day rates should reach \$5,000 within 18 months.

If he's right, it will be a bonanza. Most of the incremental revenue drops to the bottom line. Analysts are forecasting 92¢-a-share profits for the fiscal year ending in March, 1995, and a five-year earnings growth rate of 24%. That should get profits to nearly \$2 a share in three years. Steinberg thinks earnings will be \$6.

Of course, Tidewater's fleet is on average 15 years old, which means the company will have to start building boats, too. But the company can well afford it. Over the past year, Tidewater has eliminated all but \$1.5 million of its long-term debt and amassed \$78 million in cash.

HOW IT STACKS UP

	TDW	S&P 400
P/E RATIO	27.9	20.5
YIELD	1.9%	2.1%
PRICE CHANGE, JAN. 1-OCT. 4, 1994	+7.5%	-4.3%

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SPRECKELS SUGAR: A HIDDEN TREAT?

West Coast shoppers may recognize Spreckels Industries. Its sugar is a supermarket staple. But sugar hasn't been sweet for Spreckels recently. Drought and disease devastated its sugar-beet harvest so badly that by 1992 it was in bankruptcy. Shares in the reorganized company started trading over the counter last year at 10 and now go for 8¢. But Steven Van Dyke, whose Tampa-based Tower Investment Group has \$80 million invested in turnarounds, thinks Spreckels is worth nearly twice as much.

What's sweetest about Spreckels is its little-known industrial-products division, which accounts for 46% of the \$379 million in sales but nearly 90% of the operating income. About 75% of that unit is Duff Norton, which makes materials-handling equipment and is benefiting from the manufacturing boom. "Management has options that go from 11 to 13, so they have an incentive to get the stock up," says Van Dyke, who owns 250,000 shares.

The easiest way to do that, he says, is to sell the sugar unit. Chief Financial

Officer Donald Roof confirms that company's long-term strategy is to "separate" Spreckels' two units. But he says a sale in the next 6 to 12 months is unlikely because the sugar industry is depressed. The sugarcane would fetch about \$40 million, estimates analyst Andrew Lipman of a nestock. Then the remaining unit would be worth \$145 million, or six times its tax cash flow. Add an additional \$5 million in land, says Lipman, for a total of \$200 million in "enterprise value." If management exercises its stock options and the total float goes to 9 million shares, that works out to a per-share value of \$15 to \$16 after accounting for debt.

CHECK OUT AT&T'S HIGH-TECH NUMBER

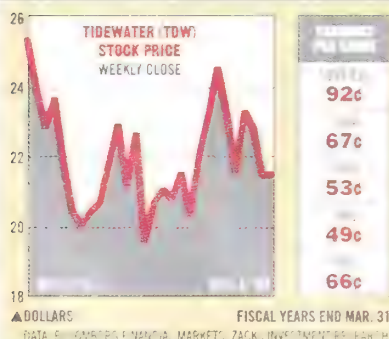
Looking for an undiscovered stock? Just reach out and buy AT&T. Michael Clark, a portfolio manager at PNC Investment Management & Research, says the stock is cheap, he says, because Wall Street still thinks of AT&T as a stodgy utility.

"What people are missing is that it's turning into a valuable technology company," says Clark, who expects AT&T now at 52¢ to hit the low 70s in a year. Indeed, Clark says that the technology component—mainly computer and telecommunications equipment—now comprises about 34% of revenue and is growing at an 18% rate. Long-distance service, which accounts for the bulk of AT&T's revenues, is only growing at 3% to 3.5% a year.

"AT&T is the only company in the world with all the pieces to the 'communications/data processing' puzzle," says analyst George Reed-Dellinger of NatWest Securities. "It's getting billions in orders from foreign telephone companies and from Baby Bells." In addition, the recent acquisition of McCaw Cellular Communications, he says, places AT&T at the forefront of wireless communications as well.

Both Clark and Reed-Dellinger expect that AT&T shares will get their boost when institutional investors start appreciating the high-tech profile and load up on the stock. Indeed, in Wall Street lingo, it's "underowned." Institutions hold only about 33% of AT&T's 45% for the stocks in the Standard & Poor's 500-stock index and 55% for the Dow Jones industrial average.

TIDEWATER IS RIDING THE WAVES



and drilling supplies to offshore oil and gas rigs. Although New Orleans-based Tidewater operates the world's largest fleet of supply vessels, 201 of its 588 boats work the Gulf of Mexico, where gas is the main product. Higher gas prices stimulate production—and boat rentals. Day rates for service boats are now around \$3,000, but Steinberg says they will rise along with gas prices.

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CHILD CARE

KIDS NEED A SAFETY NET, TOO

Communities find that day care alone isn't nearly enough

Many states have problems deciding how best to provide child care in rough urban areas. In 1988, Illinois turned to Trinita Logue, then a foundation executive, for some answers. Logue helped the state come up with a novel way to finance seven new facilities in some of Chicago's worst sections—and get the communities to provide a range of critical services to help parents.

The strategy: Force child-care agencies to compete for the new buildings by showing how they would run the centers—and how the facilities would benefit the neighborhoods. In 1992, the Illinois Facilities Fund, a Chicago-based nonprofit lender that Logue now heads raised \$13 million in the tax-exempt bond market to build the centers. Chicago Commons, a social services agency, recently opened the Nia Family Center on a desolate, drug-infested strip. But its presence is already having a wider impact on the area: The public library is working with the community to open a branch on the same block, soon to be joined by a family health clinic and an adult-literacy center for parents. Says Logue: "This is just the beginning."

BUILDING BLOCKS. Logue and other innovators around the U.S. are working to build a child-care system from the ground up. As in health care, they're experimenting with local solutions in the absence of a coherent federal policy. With more women in the workforce, their goal is to create an infrastructure for caring for and educating our youngest children.

That means more than just day-care



AT CHICAGO'S NIA FAMILY CENTER: Room for imagination

centers. Increasingly, early-childhood experts agree that children and their families need a host of services—education, health care, social support—if kids are to thrive and prosper. And a growing body of social and scientific research confirms that this support is critical during the first three years of a child's life for healthy development later. There's also a growing consensus

that without such a comprehensive system, such problems as drugs will only worsen. "We grossly underinvest in small children," says Vermont Governor Howard Dean, chair of the National Governors' Assn., who has made young kids a key priority in his administration's policymaking. "We expect the school system to fix something ignored for the first six years."

Momentum for crafting broad solutions to the child-care crisis is building (table). Some 30 states have major reforms under way to help young children and their families. Many are improving the availability and quality of child care. Others, such as Oregon, Ohio, and North Carolina, are creating a variety of educational, health, and social programs, then linking them together to meet the nation's No. 1 education goal: having children enter school ready to learn. At the same time, the federal Health & Human Services Dept. is encouraging states to run full-day programs via Head Start. Separately it is launching "Early Head Start," to serve families with kids under 3.

MATH CLASS. With so much happening, child advocates are guardedly optimistic about change. Ellen Galinsky, co-president of the New York-based Families & Work Institute, calls "communitarian planning in the early-childhood field one of the most positive things to emerge in a long time." But, she adds, "it's not without its problems." Among them: battles among competing agencies, lack of leadership, and tight finances.

No state is making more of an effort to ensure that its kids are well cared for than Hawaii. In 1993, the state, with input from the Hawaii Business Roundtable and the community, unveiled a plan for creating and financing a statewide system of early-childhood education and care, similar in scope to its universal system of health care.

HOW STATES ARE INVESTING IN CHILD CARE

HAWAII It is carrying out a plan, created by business, government, and community leaders, to create a universal system of early-childhood education and care by 2005. So far, programs include tuition help for day care and social services for poor families.

COLORADO The state has largely carried out the recommendations of a child-care council that included American Express and US West to expand child care greatly. It is now overhauling its human-services agency to make government financing easier.

NORTH CAROLINA Through a program called Smart Start, the state is spending \$40 million to ensure every child in the state enters school healthy and ready to succeed.

OTHER INITIATIVES Ohio, Illinois, and some 20 other states are linking Head Start with child care and other programs. Oregon and West Virginia are using principles from the quality movement to create benchmarks for assessing their early-childhood services.

DATA: FAMILIES & WORK INSTITUTE, BUSINESS WEEK



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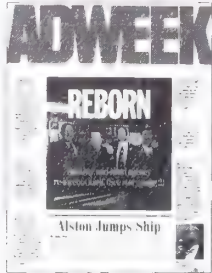


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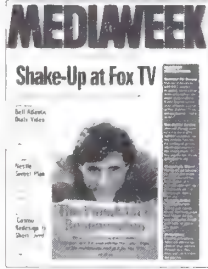
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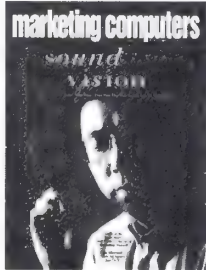

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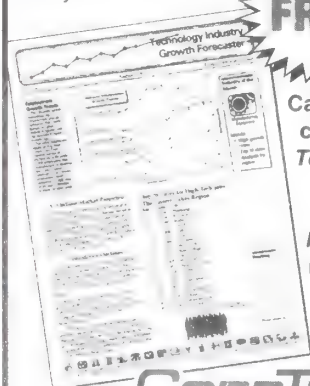
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Social Issues

goal is to offer an array of services for children from birth to age 5 by the year 2005. So far, Hawaii has launched several programs, including a tuition assistance program for day care. But it has not yet come up with the \$300 million to \$600 million it has estimated it will have to pay for this system.

Elsewhere, some companies are figuring out ways to help fill the financial gap. In New York City, a group of CEOs from such companies as Traveler Corp. and Chase Manhattan Bank are working with city leaders to improve and integrate the city's labyrinth of services for young children. A key goal is to maximize available funds while maintaining quality. Another is to figure out how to finance specific projects. "When employees can come to work knowing their children are in capable hands, both the community and corporation benefit," says City Chairman Thomas G. Labrecque.

CLEVER COLLABORATING. One way cities and states are already improving services is through public and private partnerships. Through a \$40 million program known as "Smart Start," North Carolina provides tax incentives and other resources to partnerships across the state. But the partnerships decide how best to ensure that children in their communities enter school healthy and ready to learn. John A. Walker, president of the Orange County Partnership for Young Children, says the state's insistence on collaboration is helping counties use limited dollars more effectively. For example, in 1991, Orange County estimated that it would cost more than \$2 million to provide day care for the 230 kids waiting for subsidized care. But with the help of local agencies and private donations, the county did the job for a third of the cost to taxpayers, he says.

The question is, how can policymakers replicate such successes on a wide scale? To find an answer, Governor Dean is planning to hold the first of a series of hearings on Dec. 8 in which some of the most innovative communities will share their strategies. His ultimate goal is to develop an action agenda for the states. Independently, 12 foundations with a keen interest in children have formed the Finance Project in Washington, D.C. It will "take a hard look" at how government-financed education and other children's services and identify promising strategies for generating revenues and improving returns, says Cheri Hayes, executive director. No one expects solutions to be easy. But the fact that more attention is being focused on young children and their families can only benefit everyone.

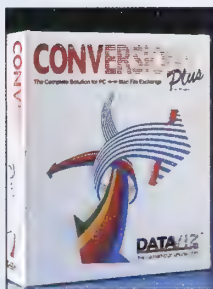
By Michele Galen in New York

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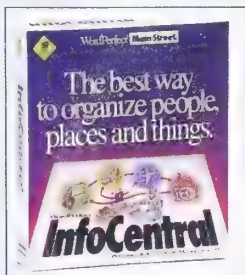
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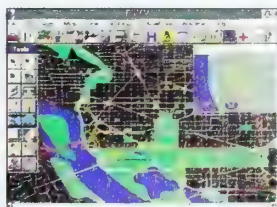
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Development Software
of Applications Software
Security
8 Software
8 Servers: Issues
8 Servers: Trends
Networking Systems
Computing Series: Servers & LAN
Computing Series: Distributed Computing
or Distributed Computing
Key Concepts

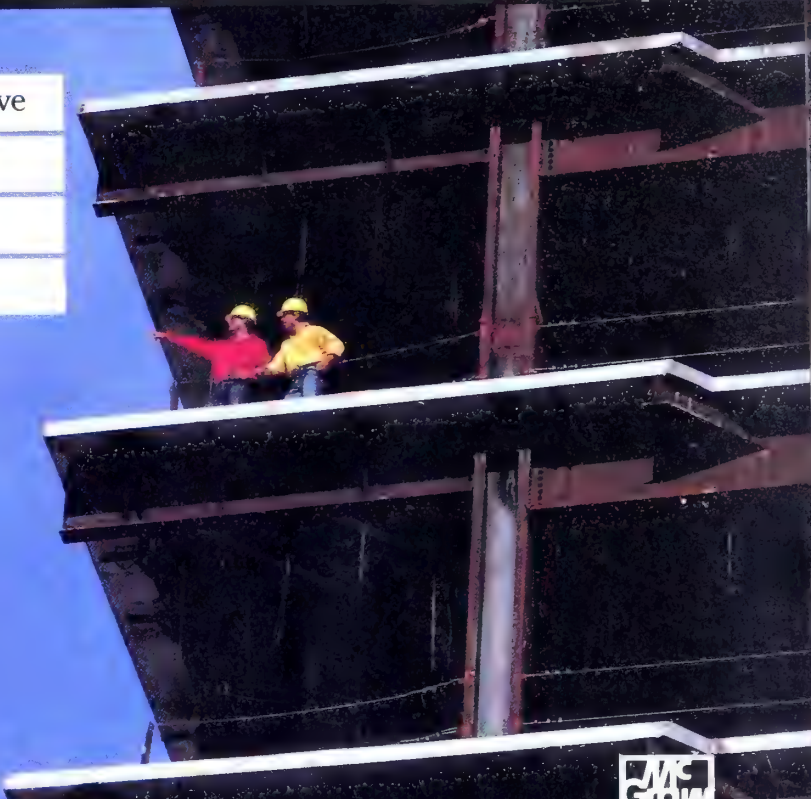
Solving the Client/Server Puzzle

Client/Server Implementation Strategies and Recommendations

As the preceding description indicates, client server computing and its implementation is a complicated, customized solution which needs to be approached with care. Now it should be understandable that client server applications are not a one-size-fits-all solution.



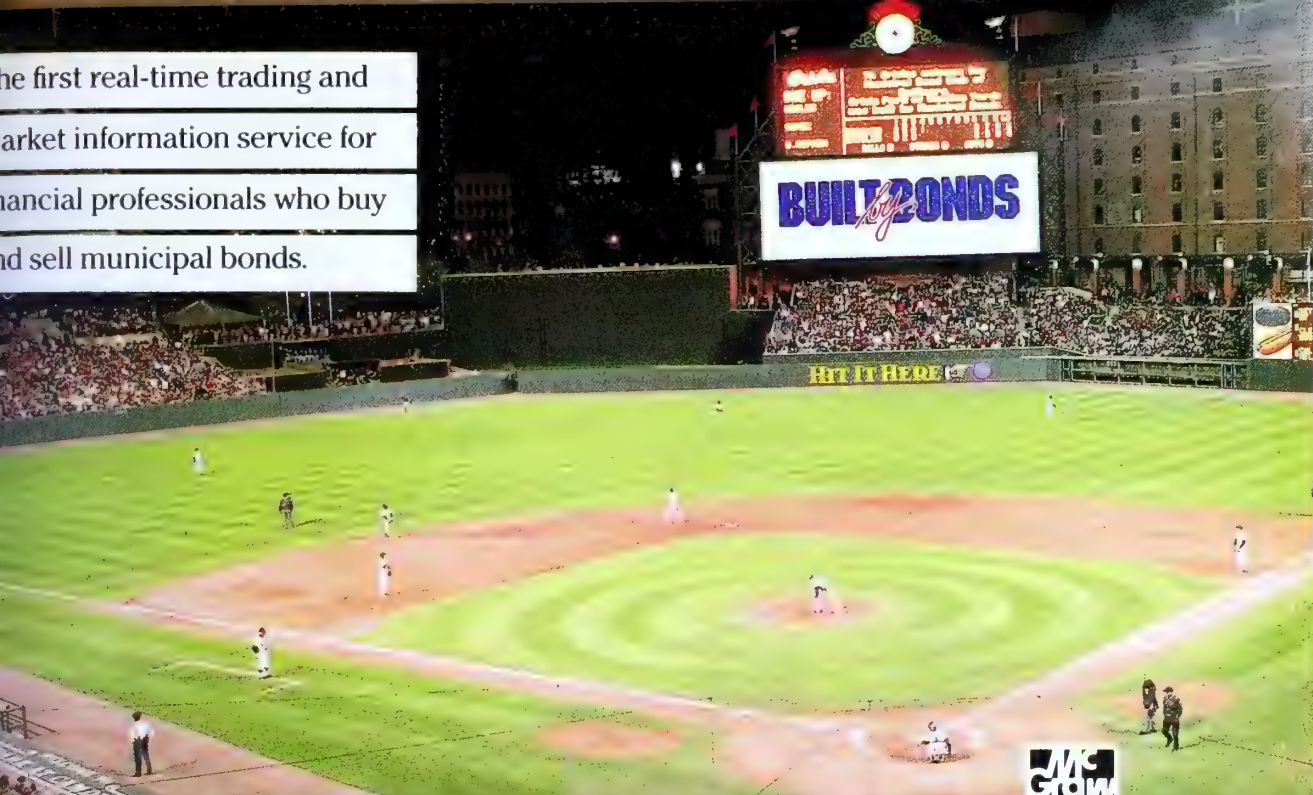
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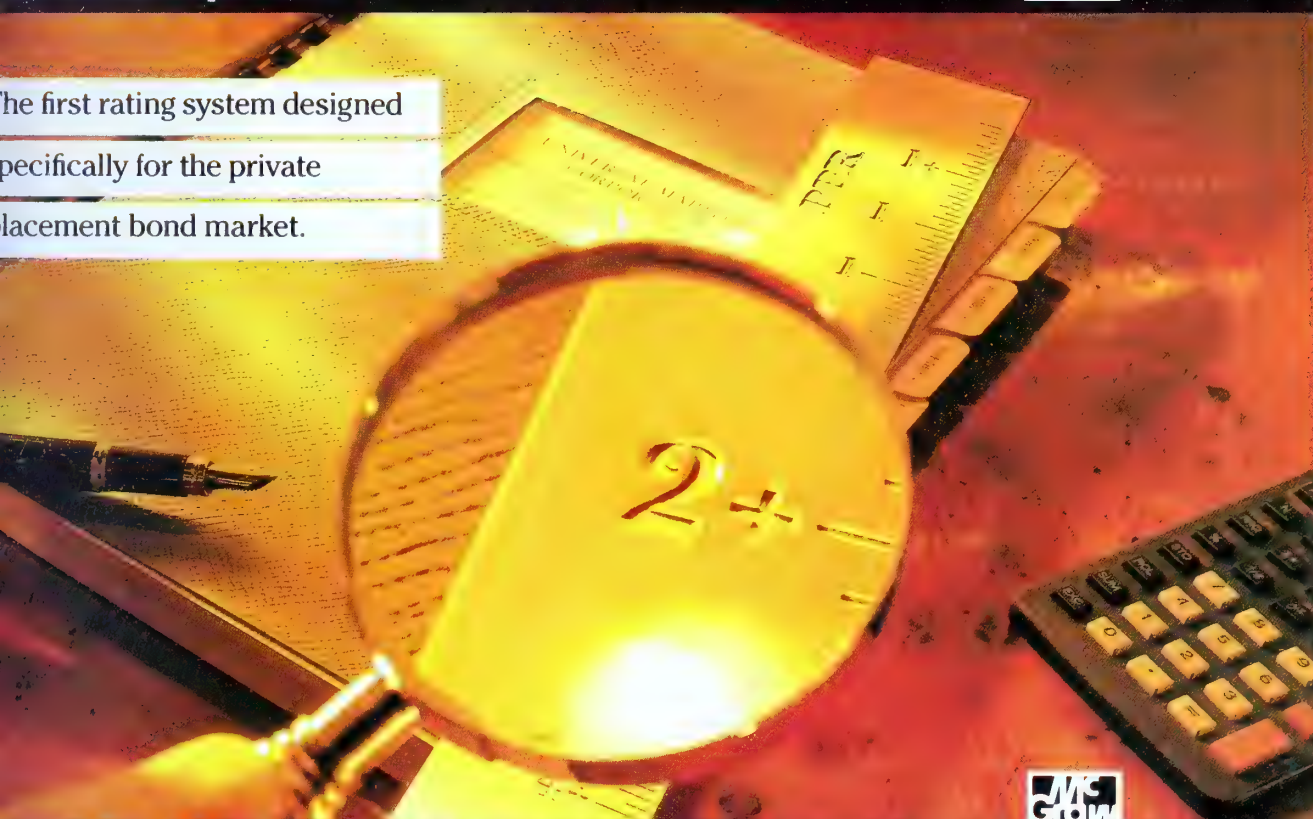
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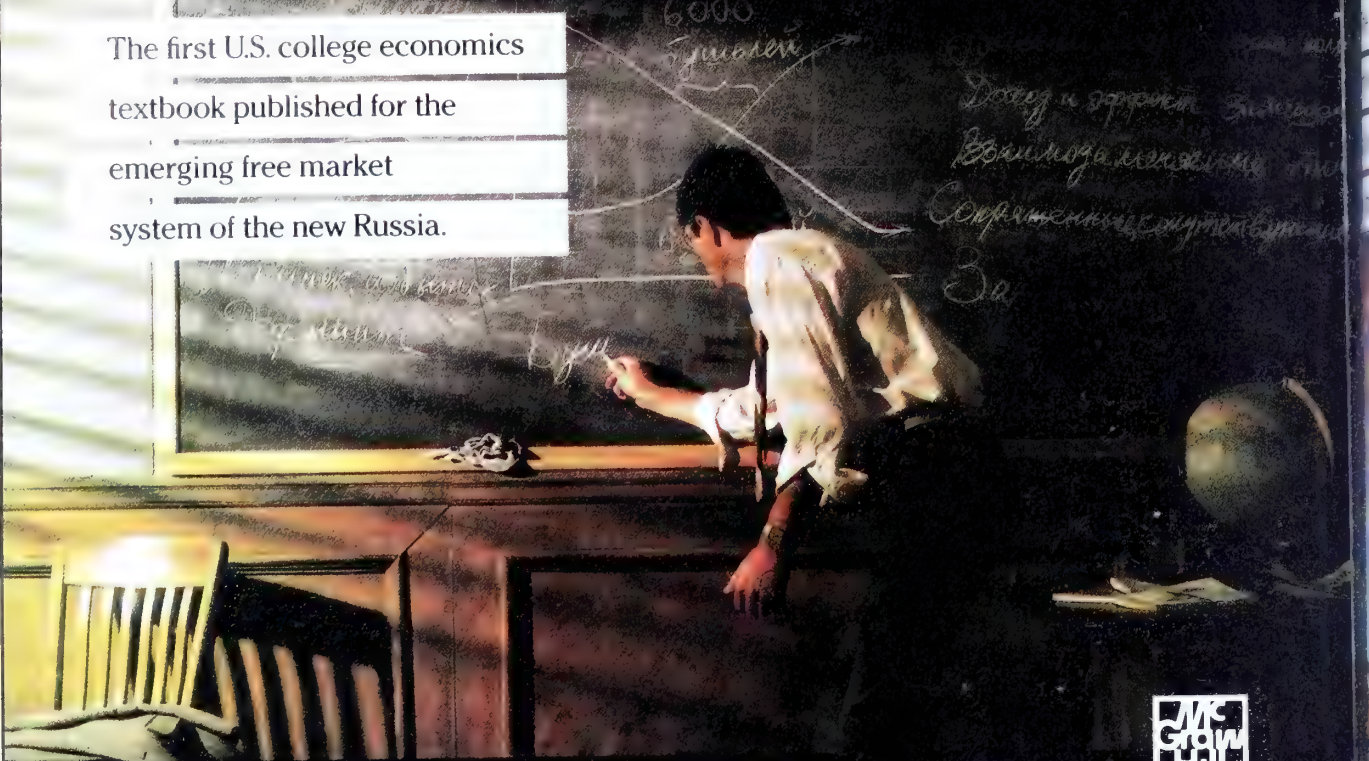


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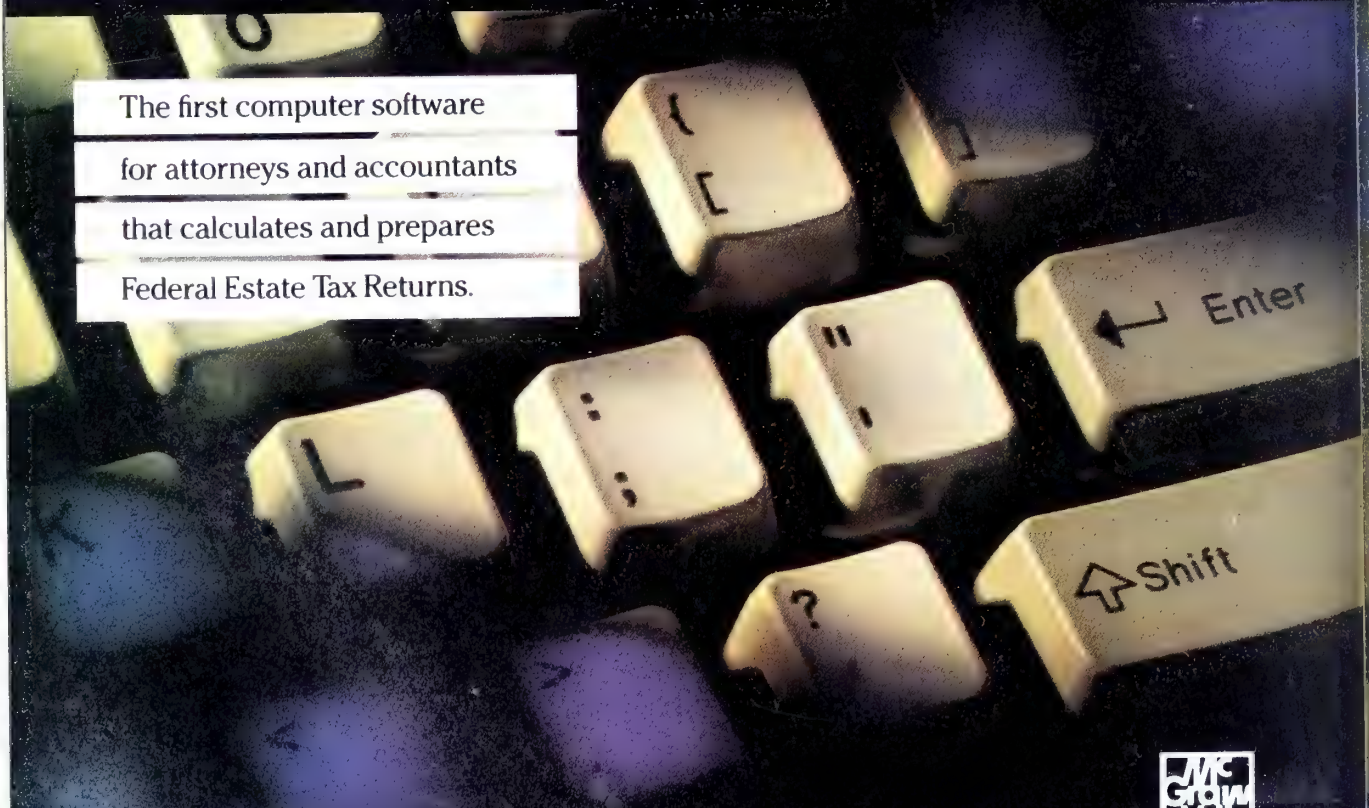


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EDITED BY AMY DUNKIN

HOW TO GET WIRED

With all the hoopla surrounding the Information Age, people just rocketing into cyberspace won't be shocked to learn that it's already pretty congested. The hardest part for the newly modemed will be figuring out the best on-line services and computer bulletin boards to steer toward.

Most PC buyers have at least a passing familiarity with the tapestry of choices provided by America Online, CompuServe, and Prodigy—

from shopping and technical support to investing tools and electronic mail. But those who dig deeper into the electronic frontier will uncover a wide variety of other offerings.

New players are piling onto the scene. In June, Apple Computer launched eWorld, a spiffy-looking—but for now sparse—virtual community aimed at Macintosh users. (An IBM-compatible version is scheduled for release in 1995.)

Ziff Communications plans to unveil the multimedia Interchange Online Network, with publishing partners such as *The Washington Post* and *Minneapolis Star Tribune*.

Starwave, another Ziff partner, will start separate sports-only and outdoor services on the Interchange network.

AT&T just unleashed PersonaLink Services, which now requires devices such as Sony's new Magic Link personal communicator.

With "intelligent" software assistants, consumers can sort through electronic mail, get a news summary, and, soon, go shopping. Microsoft is readying Marvel, which could be bundled with every copy of Windows 95 the company ships next year.

SAMPLES. Consumers are understandably intrigued by the global web of computer networks known as the Internet. The on-line world also boasts thousands of local and regional bulletin boards, many of which are improving their graphics and offering Internet links.

Slicker graphics, faster and cheaper modems, and richer information content partly explain the relentless rise in on-line interest. The number of on-line consumer subscriptions exceeded 5 mil-

lion at the end of 1994 from 1.2 million in 1989, according to Simba Information, a market researcher in Farmington, Conn. The typical individual subscribes to more than one service.

Those who have yet to join the party can usually try it out for a whirl before deciding whether to stay. Several new services come bundled with software and free on-line trials. In general, folks pay by the clock; some are charged a flat monthly rate for a fixed number of hours, after which the rate starts running up a tab. Special features carry premium prices. For example, under CompuServe's standard plan, consumers pay \$8.95 a month for a variety of basic services plus \$9.60 an hour to use the service's popular fo-

FINDING YOUR WAY ON LINE

Making A Cyberspace Connection

NETWORK	TELEPHONE	COMMENTS
AMERICA ONLINE	800 827-6364	Strong lineup of electronic periodicals. Easy-to-use graphical interface.
COMPUSERVE	800 848-8199	Comprehensive databases, forums, and technical help. More expensive than most.
DELPHI INTERNET	800 695-4005	Full Internet access without the graphics that make other services more appealing.
ECHO	212 255-3839	Trendy Big Apple electronic salon attracts many women. Has its own cable show.
EWORLD	800 775-4556	Has pleasing Mac graphics but so far, feels like a virtual ghost town.
GENIE	800 638-9636	News, forums, and E-mail, but games are the biggest attraction.
IMAGINATION NETWORK	800 462-4461	A playland with games suitable for kids and adults.
META NETWORK	703 243-6622	Hosts private electronic conferences for organizations.
PRODIGY	800 776-3449	Will soon provide better-looking software and access to the Internet.
TRANSOM	800 475-9689	Caters to 18- to 34-year-olds with features such as college-newspaper articles.
WELL	415 332-4335	Deadheads, techies, and other Sausalito sensibilities.
WOMEN'S WIRE	415 615-8989	Board for women's health issues and other female-oriented topics.





Some 60,000 bulletin boards offer the virtual equivalent of a clubhouse

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...databases and servic-
...y on more hefty fees.
...grassroots boards let
...in for free. Roughly
...public-access boards
...ranging up in North
...says Jack Rickard,
...ublisher of *Board-*
...*magazine*. These are
...ual equivalent of a
...e or bar, where us-
...software, exchange
...s, or schmooze about
...assions ranging from

bluegrass to Buddhism. *Boardwatch* publishes lists of local boards, and *NetGuide*, (\$19; Michael Wolff & Co. and Random House Electronic Publishing) organizes offerings by topic.

Most boutique boards and on-line services garner reputations. The venerable WELL (Whole Earth 'Lectronic Link) is best known as a community of computer wizards, Deadheads, and other Bay Area hipsters. General Elec-

tric's GENIE is a broad-based information service that is particularly strong in multi-player games. Delphi Internet became the first major on-line service to offer complete Internet access. ZiffNet (also accessible through CompuServe and Prodigy) covers the computer landscape.

Users who dial up Meta Network in Arlington, Va., can sound off about Washington mayoral candidate Marion Barry or discuss launching a business. In the sangha section, members can open up spiritually. Meta also encourages organizations to hold private conferences. "We don't have any Darth Vaders here," says Lisa Kimball, a Meta Network partner. "This is not a place to hack around."

Echo (East Coast Hang

Out) in New York has a local edge. It boasts topics with an attitude, such as *Opera: The Good, the Bad, and the Really Loud*. It also organizes a quarterly cultural series at an East Village public school with such participants as the Whitney Museum of American Art. Subscribers can participate in a weekly interactive show on Manhattan Cable TV. Founder Stacy Horn hopes to launch future virtual communities in Minneapolis, Boston, and other cities. As with Meta Network and other boards, though, Echo members may find it a chore to learn the arcane commands needed to get around. **WIDER NET.** Although most of the people elbowing their way through cyberspace are men, more women are slipping in. Women's Wire of south San Francisco has a decidedly female bent. Co-founder Nancy Rhine insists there is no male-bashing; men make up roughly 10% of the membership.

In the face of competition, the Big Three networks aren't standing pat. CompuServe recently brought out a multimedia companion CD. America Online and Prodigy will soon sport spiffy new interfaces. (Prodigy members will be thrilled to learn that the intrusive ads that hog the bottom of the screen will shrink.) Prodigy is also about to add Internet newsgroups, while AOL and CompuServe are moving toward more complete Internet access.

Prodigy has been active in other areas. In September, it launched a service for small businesses that includes databases from Dun & Bradstreet, Lexis-Nexis, and McGraw-Hill, publisher of *BUSINESS WEEK*. To catch up with rivals, Prodigy will introduce real-time talks with celebrities and politicians in so-called chat stadiums. Lest the arena get too unruly, members can have private talks on the side. Too many voices trying to be heard can give you a headache, in the real world or in cyberspace. *Edward Baig*

INVESTING

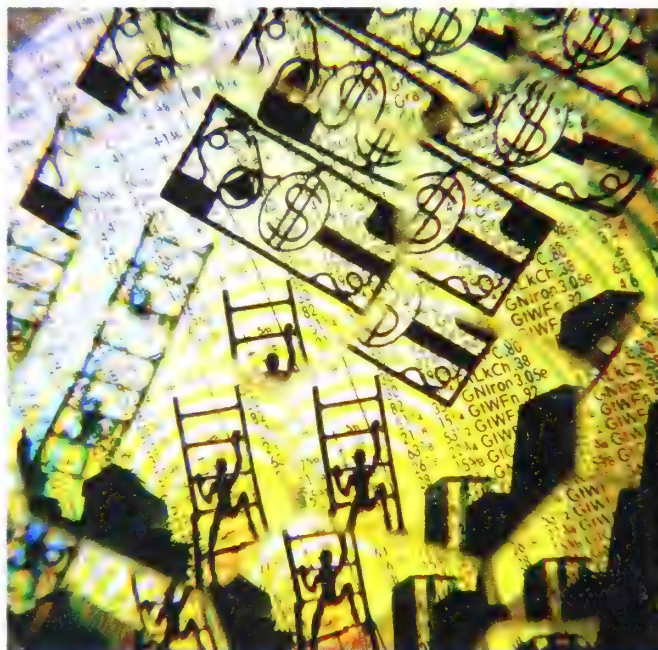
NAVIGATE THE NETWORKS LIKE A WALL STREET PRO

With their ready access to news and research, Wall Streeters have long had an edge over individual investors. But as on-line services beef up their financial offerings, you can begin to narrow the information gap. With even the cheapest services, you can track your portfolio and read news about companies whose shares you own. And they'll pair you with a discount broker, so you can buy and sell by PC.

Best of all, the expensive on-line services the pros use have recently discovered the small investor and have restructured their fees accordingly. You, too, can have on your desk a Reuters or Dow Jones terminal masquerading as a PC. Because of the way the charges stack up, you can probably afford to use it only evenings and weekends. But, hey—you have a day job to keep you busy, don't you?

LIVE FORUMS. If you just want to keep your portfolio up to date, the way to go is Prodigy or America Online. Using the least expensive plans, news and stock quotes after a 15-minute delay are virtually

free. For extra fees, you can download historical stock prices and more detailed company reports. Prodigy offers a \$1.95-a-day service, Wall Street Edge, that pulls together the best from the day's tip-



sheets and newsletters; if you plan to use it daily, you can subscribe for an extra \$19.95 a month.

Both services offer bulletin boards and live forums where you can chat with other inves-

tors. America Online has a service sponsored by the not-for-profit American Association of Individual Investors. Besides a bulletin board, it includes a reference library, and you can download popular personal finance software, such as *Retirement Planner*. To keep on top of on-line developments, you can also subscribe to the newsletter, *Computerized Investing*, for \$30 a year (312 280-0170).

FINDING YOUR WAY ON LINE

Still, it's chock full of information. You can get a year's worth of daily stock quotes and search for business series in hundreds of publications. You can call up earnings estimates from Zacks Investment Research and company financial profiles from Standard & Poor's. About the only thing it lacks is a gateway to a discount broker. However, you can subscribe to Market Navigator through Charles Schwab or Fidelityline Xpress, if you're using their programs for trading.

Another comprehensive source is CompuServe. It has everything of what you're looking for, but not covered by the \$8.95-a-month fee, so be prepared to pay for what you go. Dow Jones News/Retrieval is available on Prodigy for \$29.95 an hour until the market closes and free thereafter—initial CompuServe's \$9.60 hourly connect charge plus a \$15-a-hour surcharge.

ANALYTIC TOOLS. If you're more interested in technical analysis, Telescan is the service you want. It's a fast click of the mouse will bring up a graph to your screen instantly. Once there, the Telescan software provides tools for technical and fundamental analysis, and powerful screening programs to find undervalued stocks.

Finally, some investors like Reuters Money Network, which automatically downloads only the quotes and news you're interested in. Because of its efficiency, you don't rack up much telephone time—a big advantage in parts of the country where the on-line services don't have local phone numbers.

Chances are you're going to spend more than the connection fee on any of the services. There's always the odd analyst's report you'll want to check out, or perhaps you need to look at a Securities and Exchange Commission filing. Just think of those extra charges as a part of the commission you used to pay your full-time vice broker. *Larry Armstrong*

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REUTERS MONEY NETWORK	800 346-2024	Software that downloads news, research; meshes with Quicken and Wealth Builder	\$12.95/mo., \$9.95 more includes news
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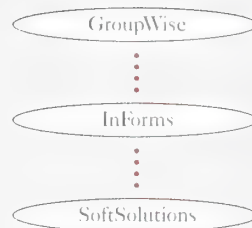
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LEARNING

A SHEEPSKIN FROM ON-LINE U.



It was something Richard Heppner had never considered. Although he was an adjunct instructor in the media department for Dutchess Community College, he still needed a master's degree in education before he could move on to a full-time teaching position. But with a busy work schedule and a family with one three-year-old daughter and another child on the way, Heppner couldn't swing the time to drive the 90 miles each week to complete his education at The New School for Social Research in New York. It almost seemed hopeless for Heppner until a friend suggested an unorthodox approach: attend classes on line.

Instead of listening to a lecture, Heppner was reading and responding to posted electronic messages from the professor and fellow students. "It was

like talking on paper," says Heppner, who now teaches full time at Orange County Community College. And although it took Heppner three years instead of two to get his degree by doing it electronically, he is a firm believer in on-line education. In fact, Heppner is even conducting a virtual class on popular culture and the media for Connected Education, the White Plains (N. Y.) service that developed the on-line courses used by The New School.

While there seems to be no official count on the number of institutions that are offer-

ing on-line degree courses, interest in creating such programs for a wide variety of undergraduate and advanced disciplines is exploding. And the rapid developments in telecommunications and computers—the basis of the burgeoning Information Superhighway—are making it easier for schools and students to connect over the vast sphere of cyberspace.

That's a good thing, since more and more people are finding it tougher to attend traditional classes because of time constraints such as hectic office hours. "On-line education can be a lifeline to those who have obstacles, such as geographical distances or physical disabilities," says Paul Levinson, director of the On-line Program for The New School (212 239-5630).

Since most on-line courses follow the Socratic teaching method, the electronic correspondence among instructor and students is often rich with thoughtful discussions. "Instead of having students interact with machines and software, it's student-to-student and teacher-to-student learning," says Steve Eskow, president of the Electronic University Network (EUN), a service that puts universities and other schools on line via the America Online network.

While learning on line currently is limited to reading and writing text messages, cheaper and faster networks could make classrooms more closely resemble their physical counterparts. Institutions such as EUN (800 225-3276)

and the University of Phoenix Online Program (800 4742) use computer networks that have bulletin boards, posting messages, libraries, research books and papers, and even conference rooms where students and teachers can gather and hold discussions in "real time."

PRICEY PLUG-IN. If you're interested in enrolling, you need simply to call the participating institution. You then be referred to a guidance counselor, who will determine your eligibility for the program you want, with any other college or

university, you have to submit an application including academic credentials.

Once you're accepted, the school will work out the technical side of connecting you with its network. In some cases, you'll be provided with software. EUN, for example, sends its students the programs needed to log on to America Online.

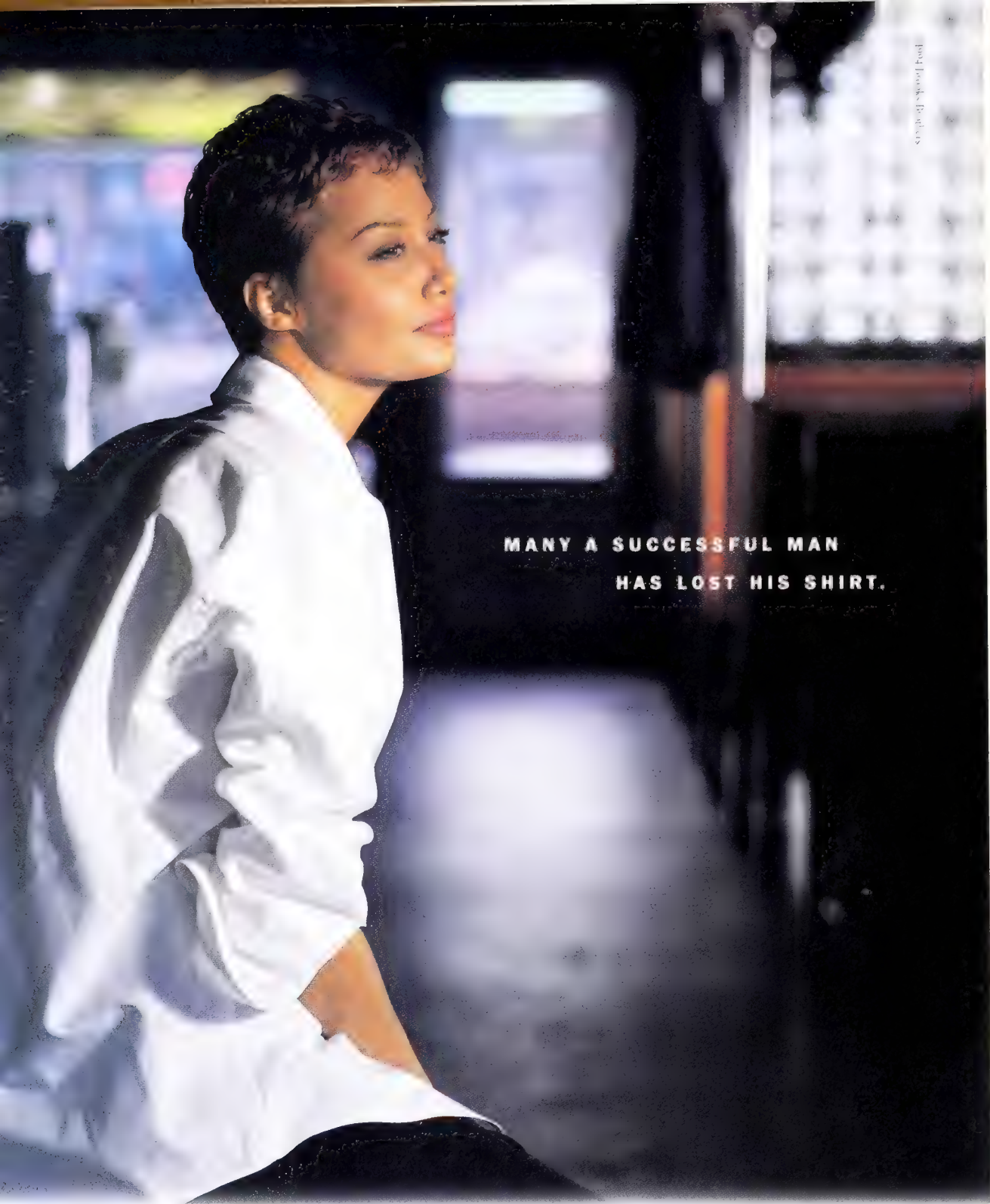
While advancing technologies help make it more convenient to learn, there are still problems with on-line education. Some programs can be quite expensive. While tuition of around \$400 per course credit is roughly par with that of conventional universities, on-line students should be aware of the hidden costs. These include work-connection charges, telephone time, plus equipment if you don't already have a computer and a modem.

Also keep in mind that while degrees of study range from an associate's degree in liberal arts to a doctorate in philosophy, not every field can be covered on line. Annually, while virtual courses are easier to fit around a busy schedule, many courses still require that students make a significant time commitment. enough on-line sessions and you could find yourself in the virtual detention room. *Paul*

FINDING YOUR WAY ON LINE

Courses Without Classrooms

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THE ELECTRONIC UNIVERSITY NETWORK	A group of 25 schools offering a variety of undergraduate and advanced degrees on America Online; costs vary with course
THE NEW SCHOOL NEW YORK CITY	Gives courses accepted by most degree programs; \$450 per credit
THE UNIVERSITY OF PHOENIX, SAN FRANCISCO	Offers instruction for undergraduate and graduate degrees; \$325 to \$445 per credit



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SHOPPING

ON-SCREEN SHOPPING: GIVE IT A FEW YEARS

Shopping on line is a little like fast-food dining. It's quick and convenient, but it's not very satisfying to the senses. No one will ever confuse the experience of on-line

products. But downloading a typical small illustration takes 20 to 30 seconds—a long time when you're staring at the screen—and the result is a picture of less-than-photographic quality.

Slow, poor-quality pictures mean that on-line shopping

Land's End catalog while getting the latest prices and entering your order by modem. Used this way, your computer becomes an alternative to calling an 800 number.

Computer gear is a natural for on-line shopping, and all of the major services offer a variety of software, hardware, and books. Prices generally match those at discount superstores, so buying this way

is especially advantageous for people in smaller communities that don't have much retail competition.

Other attractive services, designed more for looking than buying, make use of the power and convenience of computerized databases. All three major on-line operations let you download specifications on just about any car that's sold in the U.S., though they won't spare you from seeing a dealer when the time comes to buy.

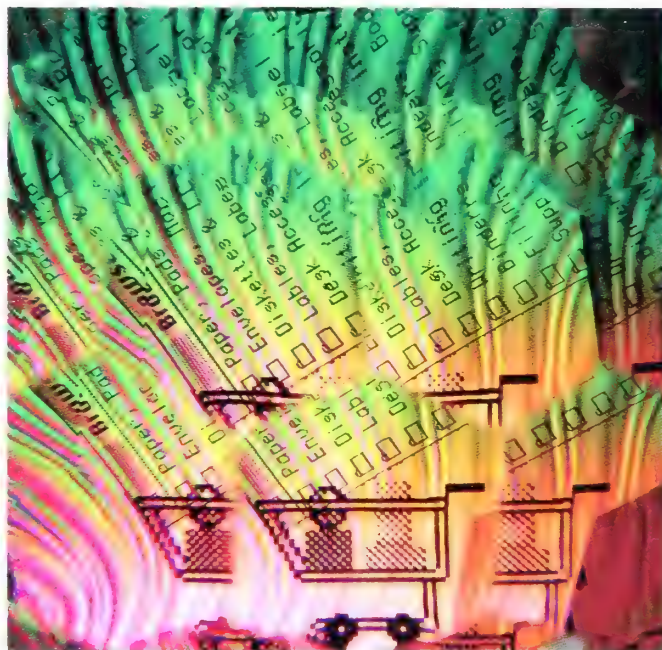
NET GAINS. AMR's widely available Eeasy Sabre reservation system allows you—in theory at least—to order plane tickets by computer. But the nightmarish complexity of airline fare structures makes actual purchases very difficult. In the end, this service—and the comprehensive, extra-cost on-line version of *Official Airline Guide*—are more useful for consulting schedules than making reservations.

A couple of experiments suggest the technological improvements that could be in

store. CompuServe is now distributing a CD-ROM maze as an adjunct to its on-line service. In the pilot edition, the material on disk was well integrated with the electronic service. But CompuServe officials foresee a future where the CD-ROM contains extensive catalog information, including text and video, while the on-line part provides current price

information and a way to order. The Internet Shopping Network, recently acquired by Home Shopping Network, offers a hint of what can be done with the higher-speed networks of the future. Using the easy navigating of the Internet's World Wide Web multimedia system makes it quick and easy—most fun—to scan through offerings of discount computer gear. The catch is you need a direct connection to the Internet of at least 56 kilobits per second—four times the speed of today's standard dial-up link to on-line services. QVC, another TV-shopping system, recently announced plans to unveil Q Online next year.

On-line shopping is still in the state of becoming. Even born-to-sell Prodigy, Missing Director Brian Eckert says, "Retailing is not what we hoped it would be." But improving technology, aided by PC could soon be as enjoyable as it is convenient. *Stephen Wilson*



ordering with a trip to the mall, let alone the pleasures of a stroll down Fifth Avenue.

The variety of goods and services available is growing daily. And the sophistication of the presentation, especially the graphics, is increasing. Prodigy, owned by IBM and Sears, Roebuck, has retailing in its electrons and is especially strong in on-line shopping. CompuServe is a close match. America Online, with far fewer merchants, is a distant third, while Apple Computer's new eWorld is struggling to get off the ground.

Still, the electronic merchants remain the captive of an inadequate technology. Retailers on CompuServe, Prodigy, and AOL have added pictures of many of their

remains mostly a text experience. That, in turn, has shaped the nature of the goods and services sold. Most of the same sort of merchandise has long been available by phone.

Flowers and gifts, such as fruit baskets, work well on line because shoppers are used to ordering such items sight unseen. If you are willing to forego the pleasures of browsing, buying books is a safe proposition. And one of the best ways to use on-line shopping is with a printed catalog in hand. You can look at the pictures in the

FINDING YOUR WAY ON LINE

What You Can Buy By Modem

SERVICE	TYPICAL MERCHANTS
FLOWERS AND GIFTS	800-Flowers on CompuServe, PC Flowers on Prodigy, Flower Stop on America Online
COMPUTER EQUIPMENT	Computer Express on CompuServe and Prodigy, PC Catalog on AOL
CATALOG CLOTHING	Land's End and J. C. Penney on CompuServe and Prodigy
BOOKS	Direct offerings from publishers on all services
PLANE TICKETS	Eeasy Sabre on CompuServe, Prodigy, AOL
CARS	Specifications and pictures on all services

B I A O !

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...ed Corporate Fund

...NOLITEN OPERA

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...CENTER FOR THE

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...NG LEADERSHIP

...ED MORE

...a Squibb Company

...rk Times Company

...n, Inc.

...and Construction

...ndation

...RSHIP

...ED MORE

...er/ABC, Inc.

...Manhattan Bank

...anking Corporation

...ed Edition Company of

...g, Inc.

...ndolph Heare

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... & Co., Incorporated

...ris Companies Inc.

...eral Foods

...ewing Company

...er Inc.

...INED LEADERSHIP

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...Express Company

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...McLennan Companies, Inc.

...sch & Co. Foundation, Inc.

...an Life Foundation

...anley & Co.

...rated

...Foundation

...erhouse

...co

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...ic Entertainment Inc.

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\$25,000 AND MORE

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Deloitte & Touche
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GE Fund
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Inc.
Avnet, Inc.
Avon Products Foundation, Inc.
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Worldwide
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The Blockstone Group
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The Chubb Corporation
Charitable Trust
Chico-Coley Corporation
Clary, Gottlieb, Street &
Hamilton
The Coca-Cola Company
Coltec Industries Inc.
Coopers & Lybrand
Crain & New York Business
Credit Lyonnais
Credit Suisse
Cushman & Wakefield, Inc.
Deutsche Telekom, Inc.
The Dun & Bradstreet
Corporation
Equitable Real Estate Investments
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Ernst & Young
The Fisher Brothers Foundation
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\$5,000 AND MORE

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The May Department
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MCA/Universal
Melville Corporation
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Manufacturing Co.
Seaburget & Berman
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Nomura Securities International
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Northrop Grumman Corporation
Ogden Corporation
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Proskauer Rose, Gertz &
Mendelsohn
Republic National Bank of
New York
Siemens Corporation
Edward Sulzberger Foundation.
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USLIFE Corporation
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Wells Rich Greene BDDP Inc.
Westpac Corporation
Wien, Mallon & Bette
One Anonymous

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Carter, Tedward & Milburn
The Chevron Companies
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LINCOLN CENTER
FOR THE PERFORMING ARTS

PLAYING GAMES

RED BARONS, RED ROBOTS, AND VIRTUAL GOLF

As I walked through the colorful city landscape, I was being stalked and didn't

know it: I was too intent on taking out a green, two-legged robot with my guns. By the time I realized that I was in danger, a red robot had snuck up behind me and let loose its cannons. The relentless barrage of fire did me in. As if I were having an out-of-body experience, I was suddenly looking down and seeing myself blown to pieces. Then, my opponent quipped: "Thanks for the points, Newbee." An announcement flashed: "You have been wasted," and I was removed from the scene.

At first glance, CyberStrike may not seem different from other combat-simulator games played on an IBM-compatible personal computer. The rules are simple: Destroy anything in your path that doesn't bear your team's color before you get smashed into oblivion by the opposing sides. I wasn't facing adversaries programmed into my software but multiple live players who could do unpredictable things. While I sat in front of my personal computer in New York, many of my opponents were guiding their robots from computer terminals in other states.

Indeed, while much has been said about the huge amount of information available through on-line networks, a significant number of subscribers would rather play games than download data. "It's a great way to combat boredom and loneliness," says

Mark Walsh, president of the GENIE Services network. "It creates a sense of commonality and conviviality."

Most major on-line systems offer simple trivia contests and adaptations of classic board games, such as checkers and chess. But the grow-



ing clamor for more sophisticated fare with eye-catching special effects is pushing some services to differentiate themselves by focusing on providing games. "There is increasing appreciation [by the networks] that on line is more than just a reading medium," says Michael Wolff, publish-

er of Netgames, *Your Guide to the Games People Play on the Electronic Highway* (\$19; Random House Electronic Publishing/Michael Wolff & Co.). It's certainly a potentially costly medium: GENIE members who play games typically spend 10% to 15% more time on line than other subscribers. One enthusiastic participant racked up charges of \$300 in one month just playing GENIE's Air Warrior. GENIE, based in Rockville,

FINDING YOUR WAY ON LINE

at once. Some have been popular since its introduction seven years ago. "How many people have game software on their pcs that they haven't played after seven years?" asks Bruce Milligan, senior product manager for GENIE's game and entertainment section.

Air-combat veterans help new members by creating scenarios, posting playing tips and offering "flight and tactics" schools to teach newcomers. **MILDER FARE.** For those who prefer nonviolent games, GENIE's services offer more peaceful options. The Imagine Network, a joint venture between game-software makers Sierra On-Line and AT&T, features more "family-oriented" fare, such as chess, checkers, backgammon, and bridge. It also offers a simplified version of Air Warrior called Red Baron, where players fly World War I planes. Its D Golf lets virtual duellists play a round of 18 holes, or in foursomes.

Even the Internet has its own playground. The most popular net games are for multi-user dungeons, where players take on roles that fit a theme and interact by typing written commands. These games are more interesting than goal-oriented contests with clear winners and losers. In a *Trek* version, you could play as pointy-eared Vulcans who explore the world from the perspective of an alien being.

Since MUDs use only text, anyone who can hook up to the Internet can play. The Internet does offer sophisticated graphical games, but they are available only to users with a high-speed direct connection. The hot number on the net is Bolo, a tank-battle game.

As the Information Superhighway develops, networks will create better, faster, more innovative games with sound effects, digital voices, and voice interaction. You're not addicted now, but you will be soon. *Pau*

The Games People Play

GAME	ON-LINE SERVICE	DESCRIPTION
AIR WARRIOR	GENIE	On most nights, up to 90 members engage in midair shoot-'em-ups
CLASSIC GAMES	Most networks	Play chess, checkers, backgammon, or bridge with unseen opponents
FEDERATION 2	GENIE	A sci-fi game where you establish interstellar trade-and-commerce networks
GOLF	ImagineNation	Tee off with up to three other people or play an 18-hole round solo

THE TAIWAN TIGER

ow short decades Taiwan has
d into one of the most pow-
economic "tigers" along the
c Rim. It's brimming with
ent products, imaginative
eurs, energetic planners and
ive cadre as talented as
l find round the world. In
e Republic of China's capital
ess bastion, there's a glow of
on at the progress the island
has made in a fiercely com-
global economy. How can a
e manufacturer not feel good
ROC ranks as the world's
h largest trading nation?
e, the ROC will rock with
excitement during World
Week, October 17 to 23, when
s of American and other for-
ors descend on Taipei to talk
cuss investment deals and
he camaraderie of global
partners. It will be a two-in-
d of festivities with the
ipei International Fair filling
World Trade Center (TWTC)
hole week and the World
nters Association General
y packing the TWTC's
onal Convention Center.
small accolade to be the
hosen to host the associa-
ver Jubilee. The organiza-
blished in 1970, promotes
onal trade through a net-
ffices and representatives
ades 71 nations and territo-
wonder it's called a "United
of Trade."

BECKONING TO FOREIGN



INVESTORS TO HELP BUILD A



HIGH TECH POWERHOUSE



By Paul Burnham Finney



Taipei, Taiwan's capital, is a major Pac Rim business center. (Courtesy of Epoch Publishing Ltd.)

BLUEPRINTING FUTURE GROWTH

But while toasting to trade, the Taiwanese business community, as well as government establishment, is doing a good bit of soul-searching these days. Hardly complacent because of recent economic and business successes, the nation is blueprinting a future in which Taiwan hopes to play a larger role that reflects its newly won stature.

Two of the top priorities in the program to enhance the country's role in the global economy:

- The ROC is working assiduously with its many trading partners to win support for joining GATT (the General Agreement on Trade and Tariffs), the organization that regulates buying and selling among nations.
- Just as important is Taiwan's goal of becoming a leading operations center for companies manufacturing and trading in the Asia and Pacific region.

Targeting High Technology

Taiwan's trump card in accomplishing this is not just its central location – 501 miles from Hong Kong, 731 from Manila, 1,318 from Tokyo and 921 from Seoul. Air service, led by China Airlines, is world-class – with Chiang Kai-Shek International Airport now nearly tripling its capacity to handle the increase in business travelers and cargo.

But what matters more in attracting U.S. and other foreign investment is the new quality image of the country's products. Once upon a time, "Made in

UNITING THE WORLD THROUGH TRADE

W E L C O M E

**WORLD
TRADE
WEEK**



WTCA 25TH GENERAL ASSEMBLY
OCTOBER 17-20, 1994



TAIPEI INTERNATIONAL FAIR
OCTOBER 18-23, 1994

Organizers: China External Trade Development Council / Taipei World Trade Center



Advanced transport facilities help make Taiwan a good regional operations center for multi-national companies. (Courtesy of Evergreen Group)

meant a low-priced, mass-product with little cachet. Many were OEM (Original Equipment Manufacture) components supplied to well-known European and American companies, but at their own names on the products. Now, Taiwanese companies like Acer, Giant and Proton are making waves along the Pacific Rim around the world, largely as a result of the ROC's major advances in technology.

TAIWAN'S TRADE TIES

With an average annual growth rate exceeding 9%, a per capita income of more than US\$10,000 and some US\$85 billion in foreign-exchange reserves, Taiwan is the very model of a country that has undergone "explosive economic development," as P. K. Chiang, Director of Economic Affairs, puts it. That the ROC "is ready to be counted among the ranks of developed nations." Last year, for example, international trade reached US\$85 billion with exports amounting to US\$85 billion and imports to US\$77 billion. In the backdrop to the events taking place this coming week at the Taipei Taiwan World Trade Center is some complex of four

modernistic towers that include an Exhibition Hall (for trade shows), the Taipei International Convention Center (3,300 seats, 19 smaller meeting rooms), the International Trade Building (back-up offices) and the Grand Hyatt Hotel (872 guest rooms, nine top restaurants and lounges, plus business and fitness centers).

Getting a First-hand Look

The TWTC will play host to some 1,000 trade-mission members and delegates to the Silver Jubilee gathering.

Included in the Trade Mission Program are:

- Presentations by top officials and executives – from government and industry – who will outline the key aspects of Taiwan's economy and trade.
- Arrangements for visitors to hold one-on-one negotiations with Taiwan businesspeople.
- Factory tours at a select number of high-tech companies.
- A trip to the HsinChu Science-based Industrial Park and the Industrial Technology Research Institute.
- A guided tour of the Taipei International Fair.

Taiwan is, of course, a market in

itself with 21-million people, rising incomes and pressing needs to upgrade its infrastructure. The country is now busy constructing a high-speed rail system, building new highways, expanding airport facilities, increasing electric-power output and cleaning up the industrial environment as part of a multi-billion dollar Six-Year National Development Plan – all of this with the aim of making life better for the Taiwanese.

There's no doubt that the ROC would like to have foreign companies contribute both money and talent to this formidable task. To make the prospects attractive, Taiwan is taking down virtually all barriers and putting out a welcome mat for foreign investors in line with the government's policy of internationalizing business and liberalizing investment rules.

Browsing Through the Merchandise

The Fourth Taipei International Fair, running concurrently with the TWTA assembly, is certain to be a magnet for manufacturers, importers and exporters from all over the globe.

Last year, Taiwan's international trade reached US\$102 billion with exports amounting to US\$85 billion and imports to US\$77 billion.

Sponsored by the sophisticated, can-do China External Trade Development Council (CETRA), which operates the World Trade Center, the fair is a major marketplace for exchanging goods and information. Through 43 offices in some 21 countries and territories, CETRA keeps

foreign companies and investors abreast of Taiwanese industrial developments and important events.

The last Taipei International Fair, held in 1992, was a box-office hit: It drew over 60,000 visitors and 4,000 participants representing more than 600 companies from 64 countries. Some US\$200 million worth of business transacted at or shortly after the

fair. This year's TIF promises to be even more successful.

PARTNERING WITH FOREIGN COMPANIES

Taiwan's recent economic growth has been nothing short of astonishing. The ROC has weathered the recession better than most countries. From 1990-93 the economy grew an average 6.03% – not the dazzling performance of the 1960s



(Courtesy of TWTC)

(9.1%), 1970s (10.2%), or the 1980s (8.2%) but ahead of many rivals.

"With over four decades of hard work," says Economic Affairs Minister Chiang, "Taiwan has created an economic miracle and gained an increasingly significant place in international trade."

During this period of breakneck development, foreign investments in the ROC have helped streamline Taiwan's management, production and marketing tactics.

Even so, the minister has cautionary words. "Currently, Taiwan is undergoing an economic transition," he explains. "Traditional labor-intensive industries are losing international competitiveness, and technical and knowledge-intensive industries have become the mainstay of the economy," emphasizing, "The key to a successful transition lies in upgrading Taiwan's production techniques and design capability. This provides tremendous opportunities for foreign technology companies to invest in Taiwan or to embark on programs of technical cooperation."

Cutting Bureaucratic Red Tape

The Economic Affairs Ministry has assigned top priority to four goals that foreign investors can help achieve.

- Improve the management and manufacturing techniques of traditional industries.
- Make Taiwan an industrial base for high-tech and high value-added industries.
- Strengthen the country's role as an R&D, financial and transportation center.
- Develop Taiwan into a regional operations center for the Asia-Pacific region.

Setting down the basic rules for protecting the basic rights and interests of outside investors are the Statute Government Investment by Foreign Nationals and a similar statute covering "overseas Chinese."

All outside investors now enjoy the same incentives as domestic investors. In most cases, they can hold 100% of the shares of a business. The exceptions are public utilities, the financial and insurance industries, and mass-media and publishing companies.

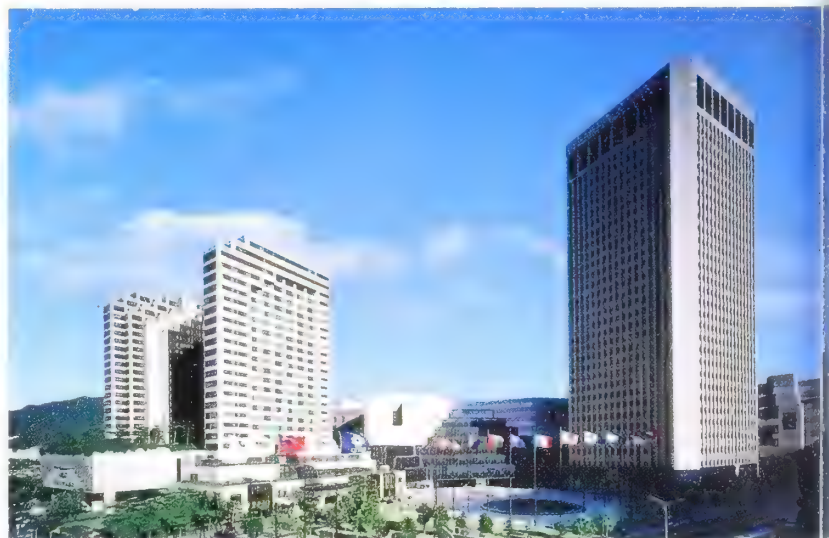
As an added sweetener, you can ship net profits or interest from your investment out of Taiwan without any interference. And after one year of an investment project, you can pull

all of your capital out of the country.

To get investments approved for the chairman of the Investment Commission – under the Minister of Economic Affairs – can now make independent decisions on about 90% of applications. And the approval process now goes swiftly in only 10 to 10 days.

Tax Incentives & Low-Interest Loans
To make foreign investment easier, Taiwan has come up with an attractive package of tax incentives.

- The government will waive from five to 20% of corporate income taxes if you invest in plants that help create international brand-name products. You also get a similar break if you purchase automatic production or pollution-control equipment.
- There's a higher depreciation rate over two years for plant and equipment purchased for R&D, quality control and energy saving.
- Foreign and overseas Chinese investors get a 20% tax break on share earnings and partnership bonuses.
- After more than two years, there's no income tax on 20% of listed shares issued for startups or expansion of technology-based companies.



The Taiwan World Trade Center has an exhibit hall, well-equipped offices, a convention center and an upscale hotel. Above left: A trade show in progress at the TWTC Exhibition Center. (Courtesy of TWTC)



WE'VE BEEN WAITING FOR THE GREEN LIGHT... FOR OVER 23 YEARS

The 21 million people living in the Republic of China on Taiwan have not been represented in the United Nations since 1971.

We are the 13th largest trading nation in the world, and we've accumulated one of the world's largest reserves of foreign exchange. To share our hard earned prosperity with others, we've set up an International Economic Cooperation Development Fund and an International Relief Fund.

We really do want to meet our obligations to the international community by helping nations in need. The problem is that our democratically elected representatives are not allowed into numerous international organizations. The Chinese communists claim they represent us and block our participation in the United Nations and other important international bodies.

The fact is, China has been divided into two separate political entities for more than four decades. Like Korea, both sides deserve recognition.

We call on the world community to give us a green light and allow us to meet our international obligations. We've been ready and willing for a long time now.

TODAY'S TAIWAN



REPUBLIC OF CHINA

Looking for investment capital? All Taiwanese financial institutions, including 51 ROC banks and 52 branch office of foreign banks, provide financial credits. If your investments fall within the Economic Affairs Ministry's guidelines, you'll come in for preferential loans at low interest rates.

SPRINGBOARD FOR MULTATIONALS

If you want to do business with the nearly dozen Pac Rim countries out of centrally located offices and plants, no country fits your needs better than Taiwan, the ministry argues. It has, among many advantages, top airline, shipping and communications facilities. Its currency – the New Taiwan dollar (NT\$26.3=US\$1 as of August, 1994) – is stable. Though mandarin is the official language, most Taiwanese in business circles speak or understand English.

With global business so dependent on people skills, Taiwan has an edge over many countries. Its work force has a high-productivity track record that would be the envy of most countries. And the Taiwanese executives who manage operations are export-oriented with considerable knowledge of Pac Rim and other foreign markets.

Taiwan's Solid Industrial Base

Underpinning all this is the country's broad industrial base, from plastics and textiles to machinery and electronics. When it comes to developing, producing and marketing, few products are unfamiliar to the Taiwanese business community.

Not long ago, BERI, an American consulting firm that specializes in "Business Environment Risk Intelligence," made an assessment of the political and economic stability in some 50 countries. Included in its criteria are profit opportunity, invest-

ment security, simplicity of investment procedures and ease of remittance. In BERI's diagnosis, Taiwan came out near the very top – with only Switzerland and Japan ahead of it.

FROM EXCLUSION TO INCLUSION

Gaining entrance to GATT is simply one more obstacle in a long line of frustrations that the ROC on Taiwan has had to endure over the years. In what the Taiwanese call the "politics of exclusion," their country has been barred from membership in the international community of nations for decades. The United Nations, the World Bank, the International Monetary Fund – these and other organizations have

kept Taiwan out or on the sidelines for decades.

Today, Taiwan is both a vibrant democracy and an economic power – with the world's 20th largest GNP and 25th highest per capita income.

Tackling the Taiwan Issue

Taiwan's failure to find the place in the sun it deserves dates back to 1949. Following the Communist takeover of mainland China in that year, most countries quickly recognized Beijing as the legitimate government of China. For all intents and purposes the Nationalist Chinese government on Taiwan and the island country itself dropped from the world's view. Since then, even great powers have feared disturbing the People's Republic of China over the Taiwan issue.

During the '80s, international opinion began to soften in the face of global realities. In 1987 Taiwan partly set the stage for change by lifting "martial law" and putting one-party dominance behind it, forging in its place a new democratic, constitutional system.

But no change has been more startling than the breakthrough relations with mainland China.

Today, Taiwan, in fact, is a leading player in China's economic growth. ROC investments in mainland industries now total US\$5 billion, best estimates, and indirect two-way trade, mostly through Hong Kong, has topped the US\$7 billion mark. Unable to compete with Southeast Asia's cheaper labor markets, many Taiwan manufacturers have moved production to mainland China where a similar culture and language made it comparatively easy to succeed. Foreign investors from Europe and North America are already using Taipei's facilities and talents as a jumping-off place for expanding business in both the ROC and mainland China.

The Penalties of Prosperity

Taiwan is undeniably prosperous, a result of its tiger-like determination to grow its economy. But today it is beset by the same competitive problems that strain the U.S. and European economies. The New Taiwan dollar has significantly appreciated. High wages lead to rising living standards – and inflationary pressures.

In short, prosperity has priced Taiwan out of major markets. And Indonesia, Malaysia, the Philippines, Thailand, and mainland China are jockeying for position in the lower markets Taiwan once dominated.

As it takes a hard look ahead, Taiwan sees two options: Move its product base out of the bargain basement into the luxury-goods department – or face economic stagnation.

The choice is clear. To remain competitive, Taiwanese companies must go upscale.

INVESTING IN HIGH TECH INDUSTRIES

The on-going policy of the ROC government is to improve Taiwan's investment environment," states Minister of Economic

Right now the government is considering a new holiday for investors in high tech or technology intensive industries.

A ▶

◀ B



To find out why more & more people are turning to Taiwan for trade & investment opportunities, fold the page so **A** meets **B**.



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That is because Hsinchu offers some of the region's best technical talent. Founded in 1980, the HSIP has long been a mecca for the best and brightest graduates of the nearby Chiao Tung and Tsing Hua Universities, two of Asia's best engineering schools. Skilled in production engineering and industrial processes, these men and women assure

the smooth operation of companies in the park. The HSIP has other advantages as well. Foreign companies receive, for example, an attractive package of investment incentives. Sourcing of components is easy due to a mature vendor base. And, located in Taiwan, the HSIP is in the heart of Asia, with strong communication and transportation links throughout the region.

These are a few of the reasons that more than 150 multinational and domestic high-tech companies have chosen the HSIP. Last year, combined sales growth was 40%. Isn't it time you found out more about the fast-growing science park in Asia?



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K. Chiang, describing the shift from labor-intensive to technology-intensive industries. The goal of the current Six-Year Economic Development Plan, budgeted at US\$302 billion, is to turn Taiwan into a center for high-tech R&D and production. At the top of the ROC's list of industrial priorities is it particularly welcomes foreign investment in biotechnology, telecommunications, consumer electronics, health care, information systems, semi-conductors and software – and in advanced materials, pharmaceuticals, precision machinery and natural resource exploitation as well.

Reviving Traditional Industry Despite a worldwide slowdown in growth, the ROC government has revised its industrial policies and aligned them with the “Statute for Upgrading Industries” and the “Act for Encouraging the Investment & Upgrading of Manufacturing Industries.” As a result, the investment climate has greatly improved. The growth in imported capital equipment reached 12% in 1992 – a sure sign that the investment is rebounding. Now, the government is offering a five-year tax holiday for investments in major high-tech or technology-intensive industries.

Back in 1952, rice and sugar together accounted for three-fourths of total exports. By 1983 it was a whole different story – with electronics, textile products, basic metals and metal products, and footwear in the lead. Last year the key export categories were electronics, machinery, and information and communications products.

Taiwan's Silicon Valley

Nothing typifies Taiwan's high-profile campaign to expand high-tech industries more than HsinChu Science-based Industrial Park (HSIP), well situated, just a 40 minute drive from CKS International Airport and 90 minutes from Taipei. During 1993, in its thirteenth year of operation, the combined sales of HSIP's 150 companies reached US\$5 billion.

Today there are nearly 30,000 scientists, engineers and production personnel working in HSIP. It's a young work force – average age 31 – nearly half equipped with a minimal education of junior or technical college and slightly more than half women.

Last year, the productivity of HSIP companies was US\$172,000 per employee because HSIP Manufacturers spend an average of 6% of sales on R&D versus 1.7% by outside high-tech companies.



HsinChu Science-based Industrial Park, the first choice for high-tech investment in Taiwan

DOING BUSINESS WITH TAIWAN

To learn more about trade and investment opportunities in Taiwan, get in touch with the local World Trade Center or a branch office of the Taipei World Trade Center and China External Trade Development Council in your city. You can also fax, phone or visit the Taipei office of the TWTC Trade Mission Program, located at 7F, 333 Keelung Rd., Sec. 1, Taipei, Taiwan; R.O.C. Telephone: 757-6846/725-5200. Fax: 757-6847-6655.

For information, brochures and other details on the Taipei International Trade Fair, contact CETRA Market Development Dept. I, 5F, CETRA Tower, 333 Keelung Road, Section 1, Taipei, Taiwan, R.O.C. Telephone: 725-5200. Fax: 757-6443.

The phone/fax code for Taiwan is 886; for Taipei, 2.

The high-tech companies in HSIP can be broadly classified into integrated circuits, computers and peripherals, telecommunications, optoelectronics, precision machinery and biotechnology.

Vital to the park's growth has been the return of some one thousand expatriates, who – at last count – had founded 73 of the 150 companies. But it's equally revealing to note that there are also 30 American, four European and four Asian companies in the corporate mix. And of the total investment of US\$2.54 billion, 21% is foreign capital.

HSIP is an ideal location for the operations centers of international companies catering to markets along the Pacific Rim. The park is already landscaping another 113 acres. And if high-tech companies pile in, as the ROC government hopes, HsinChu Science City Project will require an investment of roughly US\$4 billion over the next 25 years to fully move Taiwan into the global high-tech arena. ●

Paul Burnham Finney is a well-known American journalist who frequently writes about global business developments.



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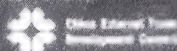
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e movie *Help!* some
ades ago. But nowa-
ine aficionados know
of any kind—from
al (uncovering the
an obscure Beatles
o the heart-wrench-
ing solace in the com-
rangers who share a
)—is but a modem
the on-line universe,
ss can peruse classi-
and make business
And people routine-
support during natu-
ers.

MOUTH. When your
r system goes ker-
er you've installed
ogram, you can send
e SOS to a technical
ative from the soft-
pany. The rep might
out—provided your

computer hasn't crashed to
the point where you're un-
able to dial out.

CompuServe, in particular,
is a bastion of technical help.
Some 700 computer and soft-
ware companies are repre-
sented. The likes of IBM, Ap-
ple Computer, and
Microsoft offer nu-
merous forums that
differentiate among
product lines or sepa-
rate novice hand-
holding from the
more complex advice
that, say, a chief in-
formation officer
might require.

Fine technical
support is also avail-
able on America On-
line, GENie, ZiffNet
(which can be ac-
cessed directly or through
CompuServe or Prodigy), and
through countless Internet
news groups. Many compa-
nies also run their own pri-
vate technical-support bulle-
tin boards.

Consumers usually receive

swift and lucid responses to
their queries. U. S. Robotics,
which handles about 450
questions a week in Compu-
Serve's Modem Vendor
forum, says its objective is
to answer within 24 hours.
But users of products from
other makers can wait days
for a reply that might as well
be gibberish. One problem:
Some companies view tech-
nical support as a profit cen-
ter, so they might accommo-
date on-line customers as
well as they ought to. Says
Barry Berkov, an executive
vice-president at Compu-
Serve: "We establish stan-
dards for replying to messag-
es, and every once in a while,
we terminate [a company]."

Often, the solution to a
technical hassle comes not
from the company that pro-
duced the errant hardware
or software, but from other
on-line users

who have al-
ready experi-
enced and diag-
nosed the problem. The
technical forums on Compu-
Serve and elsewhere contain
software-bug fixes and pro-
gram drivers that can be
downloaded, usually at no ex-
tra charge. IBM's new version
of OS/2 software, code-named
Warp and scheduled for re-
lease in October, will include
direct connections to the

er, and, if need be, automati-
cally zap you an upgrade.

When the thing that needs
fixing is your own head, your
computer may take the place
of a shrink's couch. The Inter-
net, for instance, is filled with
groups that Sigmund Freud
might have admired: alt.psy-
chology.help, alt.abuse.recover-
y, and alt.support.depression
among them.

SAFETY. Hundreds of medi-
cal and self-help groups re-
side on line, too. Last fall,
America Online launched the
National Multiple Sclerosis
Society Forum where users
can access libraries and talk.
AOL's Health & Medical Chat
forum offers real-time discus-
sions with cancer survivors.
Other topics include chronic
fatigue syndrome, panic dis-
orders, AIDS, and marital
troubles.

CompuServe's Health &

Fitness Forum
provides three
regularly sched-
uled one-hour

Alcoholics Anonymous meet-
ings a week, plus weekly ses-
sions for Overeaters Anony-
mous and Narcotics
Anonymous. "When some-
body wants to recover from
an addiction, the safety and
anonymity of a computer
screen can be a real asset,"
says Wendell F., a recovering
alcoholic who oversees the fo-

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RESOURCE	ADDRESS/PHONE	INFORMATION
AMERICAN SELF-HELP CLEARINGHOUSE	St. Claires-Riverside Medical Center, Denville, N.J. 07834	For a list of on-line self-help groups, send a self-addressed stamped envelope
THE BLACK BAG BBS	Collegeville, Pa. 610-454-7396	Allows you to download a list of health-related bulletin boards with your modem
BOARDWATCH MAGAZINE	800-933-6038	The October issue contains 506 technical product-support bulletin boards

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ternet software included
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version of the program load-
ed on your personal comput-

rum's recovery sections. Even
so, he urges members to at-
tend in-person meetings.
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therapy are enormous, he
admits: "There's no substi-
tute for a warm handshake
and hug." *Edward Baig*

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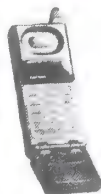


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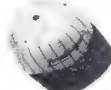
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Friday, Oct. 14, 8:30 a.m. ▶Output in the nation's factories, utilities, and mines in September is expected to have advanced by 0.4%, according to the MMS survey. That rise would be somewhat slower than the August gain of 0.7%, which was lifted by a surge in auto output, as carmakers geared up their production lines again following plant shutdowns for model changeovers. The more moderate September increase suggests that the rate of capacity utilization held steady in the month at the August level of 84.7%. However, that is still close to the reading that, in the past, has been associated with supply bottlenecks and price pressures.

Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

AcroMed 169
Aetna Life & Casualty 98
Agip 73
AirTouch
Communications 178
Alcoa 155, 196
AlliedSignal 76
American Airlines 76, 190, 196
American Express 60, 196
American International Group 196
America Online 3, 242, 244, 245
America West 48
Ameritech 178
Amgen 204
Amoco 73
AMR 244E8
Apple Computer 242, 245
Arthur D. Little 12
AT&T 178, 230, 242
Autodesk 186
Avid Technology 100
Avitas 48, 190

B

Bankers Trust 196
Bank of America 224
Bayer 64
Bäumler 64
Bear Stearns 224
Bell Atlantic 178
BellSouth 102, 178
Berkshire Hathaway 48
Biosys 12
BMW 64
Boeing 196
Booz, Allen & Hamilton 218
Bosch 64
Bristol-Myers 196, 204
British Airways 48, 64, 92
British Sky
Broadcasting 68
British Telecom 68, 92
Broderbund Software 27

C

Cambridge Technology Partners 76

Capcom 58
Cargill 60
Carter-Wallace 60
Castle Rock 8
CBS 50, 58, 196
Centocor 204
Century 21 56
Chargeurs 68
Charles Schwab 244
Chase Manhattan 6, 218, 232
Chemical Banking 218
Chevron 196
Ciba-Geigy 204
Citicorp 196
Coca-Cola Bottling 6
Columbia/HCA
Healthcare 60
Community Assets
Management 224
Community Bankers 224
CompuServe 242, 244, 244E8, 245
Computevision 186
ConAgra 60
ConnectEd 244E4
Continental Airlines 48, 64
Continental Bank 76
Corning 6, 196
CPH Chemie 64
CS First Boston 218
Cummins Engine 76
Cyprus Amax Mineral 76

D

Daimler Benz 64, 155
DC Comics 58
Dean Witter 6, 34, 97
Delta Air Lines 190
Detroit Diesel 155
Deutsche Bundespost
Telekom 64
Diesel Technology 155
DEC 64, 186
Dow Jones 27, 244
Duff Norton 230
Dun & Bradstreet 27, 176, 242
DuPont 48, 196, 204

E

Eastman Kodak 196
Echo 242
EDS 12

Electronic University
Network 244E4
Eli Lilly 204
Emerson Electric 196
Enron 73
Equifax 12
Ernst & Young 92, 218

F

Fahnestock 230
Fiat 73, 92
Fidelity Investments 244
Fininvest 73
First Chicago 218
Fixed Income
Management Group 12
Ford 76
Frito-Lay 95

G

G.D. 73
Gannett 196
Gartner Group 184
GE 50, 242
Genentech 63, 204
GEnie 245
Glaxo 204
Global Forestry
Management Group 8
GM 6, 155, 196
Goldman Sachs 60
Goodyear Tire &
Rubber 100
Gramercy Pictures 58
Granada 68
GSC Group 224

H

HealthTrust 60
Hewlett-Packard 88, 96
Home Shopping
Network 244E8
Honeywell 196

I

IBM 6, 60, 64, 76, 88, 184, 186, 196, 244E8, 245
IBP 60
Ilmor Engineering 155
Image Comics 58
Imperial Chemical
Industries 204
Infosys Technologies 92
Intel 88, 96, 186
International
Armoring 70

International Paper 196
Internet Shopping
Network 244E8

J

J.C. Penney 196
Johnson & Johnson 196, 204
J.P. Morgan 34

K

Kenneth Leventhal 224
Kimberly-Clark 100
KLM 190
Kmart 12, 196

L

Lehman Brothers 178, 204, 218, 224
Levi Strauss 95
Lexis/Nexis 242
Lipper 8
Lufthansa 64

M

Malone Advertising 100
Manhattan Cable TV 242
Marriott 190
Marvel Entertainment 58
MCA 50
McCaw Cellular 178, 230
McGraw-Hill 242, 249
MCI 60, 178, 196
McKinsey 64
Mead Data 60
Medtronic 186
Merck 204
Merrill Lynch 6, 58, 218
Meta Network 242
MFS
Communications 178
Michael Wolff 242
Microsoft 27, 184, 186, 242, 245
MMS International 249
Mobile Natural Gas 184
Morgan Stanley 6, 218
Motorola 184

N

NatWest Securities 48, 230
Nestlé 73
New Line Cinema 58
News 68
Nomura Securities 224
Northwest Airlines 97, 190
Nynex 178

O

Olivetti 73
Orix 92
Osteotech 12

P

Pacific Telesis 178
Pan Am 60
Parametric
Technology 186
Parsytec 64
Pearson 68
Penske 155
PepsiCo 95
Pfizer 204
Philip Morris 73
Pirelli 73
PNC Investment
Management 230
Potamkin Cadillac 155
Prodigy 242, 244, 244E8, 245
Prudential
Insurance 224
Prudential Securities 46
Pulaski Furniture 76

Q

QVC 244E8

R

Ralston Purina 196
Random House 242
Raychem 76
Raytheon 196
Reed Elsevier 60
Reuters 244
Roche 204
Rochester
Telephone 178

S

Salomon Brothers 34, 186, 190, 218
SAP 64
Sara Lee 196
Sears 98, 244E8
Shaman
Pharmaceuticals 204
Siemens 64, 92
Simba Information 242
SmartPhone
Communications 27
Smith & Nephew
Richards 169
Sofamor/Danek
Group 169
Software 64
Sony 50, 242
Southland 76
SouthWest Airlines 48, 190
Spreckels Industries 230
Sprint 178
Standard & Poor's 27, 244
Starwave 242

State Street Bank
Trust 218
Steinberg Asset
Management 21
Sun Studs 8
Swanson Analysis
Systems 186

T

Tele-
Communication
Telepiu 73
Telescan 244
Texaco 196
The Limited 196
Tidewater 230
Time Warner 50, 196
Toshiba 92
Tower Investment
Group 230
Transportation
Group 190
Travelers 232
TWA 97
Twentieth Century
Fox 68

U

UAW 6, 76
Unilever 73
United Airlines
United Technology
Universal Pictures
USAir 48
U.S. Bancorp
Mortgage 56
USF&G 76
U.S. Robotics 24
U S West 60, 178

V

ValuJet 190
VeriFone 96
Viacom 68
Volkswagen 64

W

Walt Disney 58
Women's Wire 24
Workgroup
Technologies 18

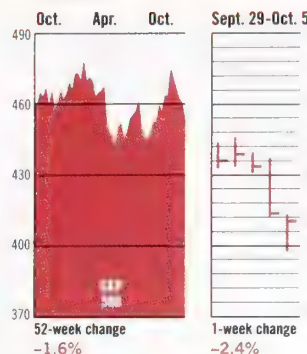
Z

Zacks Investment
Research 244
Zeneca 204
Ziff
Communication
245

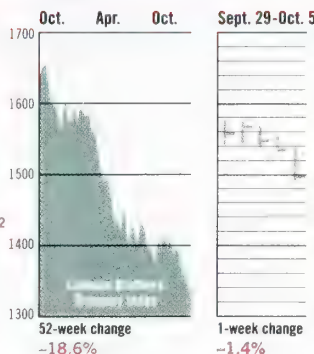
Investment Figures of the Week

week could be the word: down. Inflation and stock After a 45-point drop in the Dow Jones industrials on Oct. 4 by fears of ever-escalating big-cap decline, the Dow fell 13 points to 3787—its first drop since August. The Treasury's climbed on Oct. 4 and rate worries eased strong retail- and services, and word of a projected rise in factory

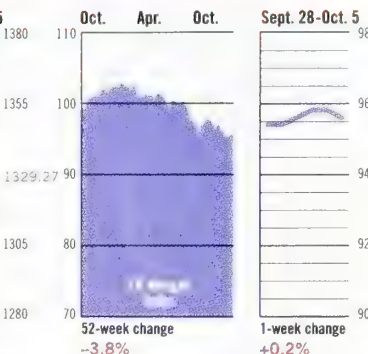
STOCKS



BONDS



THE DOLLAR



ANALYSIS

	Latest	Week	% change 52-week
INDUSTRIALS	3787.3	-2.3	5.2
INDUSTRIALS (S&P MidCap Index)	170.7	-2.2	-2.5
INDUSTRIALS (Russell 2000)	249.4	-2.0	-2.0
INDUSTRIALS (Russell 3000)	261.2	-2.3	-2.3
	Latest	Week	% change (local currency) 52-week
ASIA (TIMES 100)	2956.3	-2.7	-4.7
EUROPE (INDEX)	19,751.6	1.3	-3.7
COMPOSITE	4253.4	-2.7	4.9

FUNDAMENTALS

	Latest	Week ago	Year ago
90-DAY TREASURY BILL YIELD	5.07%	4.60%	3.04%
30-YEAR TREASURY BOND YIELD	7.95%	7.81%	6.01%
S&P 500 DIVIDEND YIELD	2.80%	2.74%	2.74%
S&P 500 PRICE/EARNINGS RATIO	17.9	18.3	21.7

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 200-day moving average	460.8	460.9	Negative
Stocks above 200-day moving average	34.0%	37.0%	Positive
Speculative sentiment: Put/call ratio	0.76	0.77	Positive
Insider sentiment: Vickers sell/buy ratio	1.44	1.42	Positive

BLOOMBERG FINANCIAL MARKETS

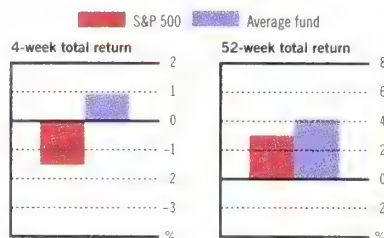
GROUPS

	4-week	% change 52-week
GLASS CONTAINERS	4.7	2.7
...	4.7	18.0
...	4.0	12.9
...	2.8	-11.1
PRODUCTS AND SUPPLIES	2.5	22.3
	4-week	% change 52-week
...	-13.1	-5.3
...	-13.0	-25.0
APPAREL RETAILERS	-11.0	-13.2
...	-10.5	-2.5
MATERIALS	-10.3	-23.6

	4-week	% change 52-week	Price
Strongest stock in group	4.8	6.6	38 1/8
CROWN CORK & SEAL	7.4	17.3	36 3/8
MERCK	10.3	15.3	25 1/2
AMERICAN BARRICK	14.4	8.1	26 3/4
CINCINNATI MILACRON	8.1	25.1	46 3/4
BECTON, DICKINSON		% change 52-week	Price
Weakest stock in group	-14.6	-8.4	54 1/4
ROADWAY SERVICES	-24.5	-60.0	5
USAIR GROUP	-14.5	11.6	32 1/2
GAP	-16.7	-5.2	58 3/4
FEDERAL EXPRESS	-14.4	-26.6	23 1/8
MASCO			

FUNDS

	%	LAGGARDS	%
Four-week total return			
STRATEGIC INVESTMENTS	10.4	FIDELITY SELECT AIR TRANSPORTATION	-10.9
COMMUNICATIONS & INFORM. A	9.6	MFS RESEARCH C	-9.3
D	9.5	FIDELITY SELECT FINANCIAL SERVICES	-7.0
...			
52-week total return			
STRATEGIC INVESTMENTS	77.9	STEADMAN OCEANOGRAPHIC TECHNOLOGY	-37.4
EMERGING MARKETS INSTL.	49.6	MONITREND GOLD	-30.7
HIGH LATIN AMERICA A	48.6	AMERICAN HERITAGE	-27.7



MORNINGSTAR INC.

PORTFOLIOS

	represent the				
	of \$10,000				
	year ago				
Foreign stocks	\$11,305	Gold	\$10,984	Money market fund	\$10,206
-1.09%		-0.85%		+0.05%	
U.S. stocks	\$10,136	Treasury bonds	\$8,904		
-1.61%		-0.47%			

DR/MCGRAW-HILL

are as of market close Wednesday, Oct. 5, 1994, unless otherwise indicated. Performance and share prices are as of Oct. 4.

of market close Oct. 4. Mutual fund returns are as of Sept. 30. Relative portfolios are valued as of Oct. 4. A more detailed explanation of this page is available on request. r=revised

REVOLUTION IN AMERICA'S WORKPLACE

It's getting positively Darwinian. The American workplace, once a protected habitat offering a measure of prosperity in exchange for a lifetime of dedicated work, is now a dangerous place. A high-risk, high-reward culture is brutally shoving aside the get-along, get-ahead work etiquette of the past. Where once there was a comfortable middle for most people, now there are winners and losers. Like it or not, Americans are being forced to give up security for opportunity and stability for mobility (down as well as up).

The great danger is that the losers will seek scapegoats. Nativist noises about unfair foreign competition and elitist Big Business have already been sounded in the national debates over NAFTA and GATT. Polarization of the workforce runs the risk of further splitting an already fragmented population. That must not be allowed to happen.

There are no villains at work, just the inexorable forces of economic and technological change. The remaking of the world of work is but a means to one end—boosting productivity. Corporations and employees are cutting costs, changing behaviors, and taking new risks for good reason. There have been no gains in real profits or wages for years, thanks to low productivity. It had to change (page 74).

HIGH RISK, HIGH RETURN

The driving force is, of course, global competition. Beginning in the '70s with a revitalized Europe and Japan, and dramatically expanding in the '90s, with 3 billion new workers, producers, and consumers joining the international marketplace, global competition is completely changing America's business universe.

Only a high-risk, high-gain strategy can generate the kind of productivity able to win in this difficult game. For companies, taking risks to leverage capital and invest in new overseas markets is one way to get that kind of productivity. Employees, for their part, must champion new technologies and new ways of working. As winning corporations and workers grab global market share and generate more revenue and profits, they garner a larger portion of all the available rewards. The result? An unprecedented widening of the income gap between winners and losers in the workplace.

If there are no villains, there are certainly victims. Companies are slimming down, using fewer, better educated, and better trained employees. Pay systems are increasingly based on contribution and performance, not longevity and status. Downsizing and restructuring are creating a multitiered work society, with companies maintaining a small workforce for their core competencies and outsourcing everything else. While hundreds of thousands of corporate refugees are becoming entrepreneurs, selling their services back to the corporate world that exiled them, millions more edge toward the slippery slope of downward mobility and the end of a middle-class way of life.

What is to be done? The first call will be for redistribution,

choosing the European model. As wealth accretes to the winners, there will be pressure on Washington to tax successful corporate and individual risk-takers to subsidize those who can't manage risk or who place the wrong bets. If that happens, a permanent army of 10% or more unemployed in Europe, redistribution is the way to go.

There is a better path. Embrace risk and go for growth. A strategy of fast growth, especially one based on global markets, can generate high real profits plus high-skilled, high-wage jobs. Even now, with the U.S. growing at near zero, shortages of skilled labor are forcing companies to hire and train thousands of unskilled people, train them, and make them winners in the global competitive game.

GO FOR GROWTH

Can government contribute? Absolutely. First, it can get out of the way. Growth is the single most important goal for the problems of a high-risk, high-gain society. Government enlarges the opportunities for everyone and raises the stakes of winning for a greater percentage of the working population. The single most important thing government can do is support risk-takers and boost productivity by streamlining the delivery of its own services, from education to export services. Eliminating regulations, which, with the best of intentions, act to raise the cost of employment and production, can increase efficiencies still further. There are many costs values reflected in safety and environmental regulations. But these thousands of regulations must be carefully weighed against the important task of supporting risk and stimulating productivity.

Second, government can actively reinforce the new risk-taking economic culture. It can change the tax system to provide incentives for training and education. It can remove barriers about health care and make it, together with pensions, more affordable. And it can reduce its own spending, raising the financial return available to individuals and corporations for taking higher risks.

These are difficult times for many working people in America. Insecurity is hard to endure. But it is the price that must be paid in every period of upheaval, and the current technological revolution is not that much different. It is every bit as powerful as the Industrial Revolution. Yet it is all too easy to get gloomy about the new economic Darwinism. Just a few years into the high-risk, high-return society, productivity is again surging, corporate profits are at historic highs, new businesses are starting up at a record pace, and, most important of all, real wages for average workers are finally starting to move higher.

More than ever, it is the basics that will get America through these trying times—innovation, capital, trade, and true grit. The barnacles of complacency have been shaken off. The animal spirits of business are being released. Risk brings its own rewards.

The arrival of Phil Mickelson on the professional tour was greeted with great anticipation, following his brilliant career as a junior and collegiate player. Phil posted three consecutive Rolex Junior Player of the Year awards from the American Junior Golf Association, three NCAA individual championships, a U.S. Amateur title,



First victory as a professional at Torrey Pines, 1993

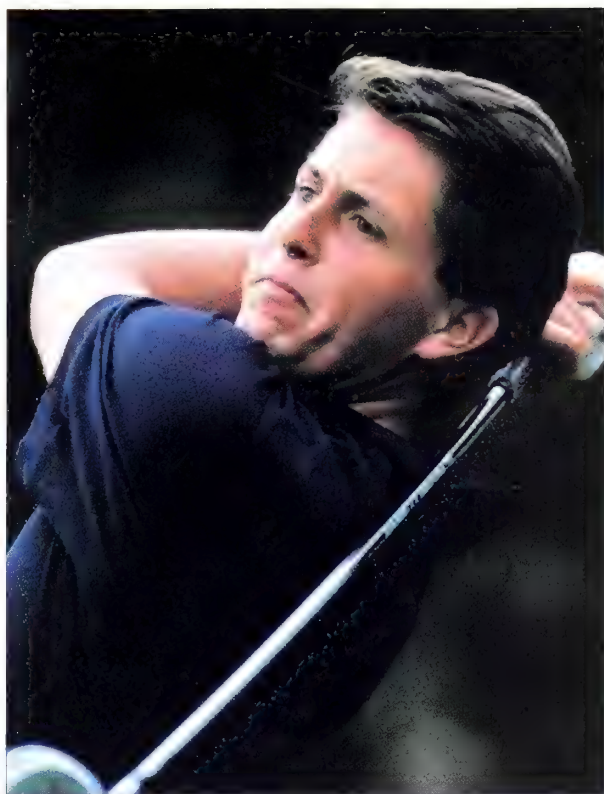
and a victory in a PGA event as an amateur. Not since Nicklaus has anyone accomplished so much at such a tender age.

"I feel a responsibility to give something back to golf because of all the support my family, friends, and the galleries have given me," said Phil. "That's why I'll be working with Rolex to support junior programs, trying to inspire more



Three-time AJGA Rolex Tournament of Champions winner

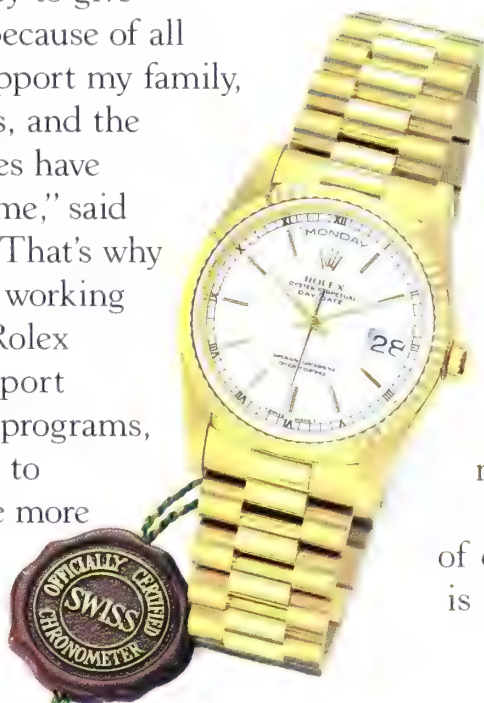
young golfers to stick with this great game."



"I love the competition, the galleries, and everything about the game."

Phil Mickelson

A long hitter with a brilliant short game, Phil Mickelson also has uncommon grace under pressure and natural charisma. Now he is taking on the rigorous challenges of the PGA Tour; and it's not surprising that his partner in the pursuit of excellence is Rolex.



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Write for watch brochure. Rolex Watch U.S.A., Inc., Dept. 388 Rolex Building, 665 Fifth Avenue, New York, NY 10022-5383
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when they were
just dreaming
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Power Macintosh

Steve Archuleta
Director, Systems for Mass
Markets Service Delivery
US West, Phoenix

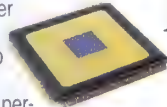
During the week, Steve manages the systems and processes that support 11 million customers in 14 western states. On weekends, he dotes on his granddaughter, rushes the net on the tennis court and, "when I'm feeling daring," scales the face at local rock climbing havens.



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BusinessWeek

OCTOBER 24, 1994



Cover Story

62 THE BEST B-SCHOOLS

The Wharton School's innovative MBA program stresses "people skills" and practical problems. That, along with a new emphasis on teaching, helped propel it to No.1 on our Top 20 list

70 THE METHOD TO OUR MATH

How BUSINESS WEEK turned raw data into real-world rankings

71 WHAT MBA GLUT?

Plenty of grads are getting offers—and options, bonuses, tuition refunds...

73 PROFS AT THE HEAD OF THE CLASS

Students bestow the honors on those who have a genuine desire to teach

Top of the News

32 AMEX SHUFFLES THE DECK

Can its Optima True Grace card attract enough users to recharge the company's empire?

34 ARE IBM AND APPLE A DAY LATE?

They may have missed their chance to create a new standard based on the PowerPC chip

36 "THE TEFLON VICE-PRESIDENT"

All the discontent that has stuck to Clinton has slid off Gore

37 LARRY KING INC.

The schmoozer in suspenders is raking in a cool \$4 million a year

38 GE'S EMPTY CHAIR

A key witness in its diamond price-fixing trial won't take the stand

40 TROUBLE AT CBS

Low ratings, lost affiliates, undone deals—this just isn't its year

42 "I AM TREATED... LIKE A VIRUS"

Why GSA head Roger Johnson may be forced out of Washington

43 THE CFTC'S NEW HAWK

Mary Schapiro plans to put teeth in commodities and futures regulations

44 COMMENTARY

Game theory's good news: There's more than one way to skin a cat

45 IN BUSINESS THIS WEEK

The healing at NME, biotech blues, Big Steel and the minimills, intrigue at U-Haul, Katzenberg's new studio, Ernst & Young, working women

International Business

50 MARKETS

Two tigers sharpen their stock: exchanges: Korea is opening its door to more foreign investment, while Taiwan, the cleanup of a freewheeling bourse may have begun

52 FRANCE

EU rivals are howling over huge handouts to state companies

56 MEXICO

The government cracks down on music pirates

59 INTERNATIONAL OUTLOOK

Endgame in Iraq? Why Saddam's war backfired

Economic Analysis

22 ECONOMIC VIEWPOINT

Kuttner: Voodoo II from the GOP

26 ECONOMIC TRENDS

The U.S. upturn, health progress, policy, stock market profits

29 BUSINESS OUTLOOK

U.S.: Simmering, not overheated
Britain: Wrestling with inflation

STORY

OLS

r, Kellogg
-this time,
ton School
ur biennial

MBA

S page 62



INTO THE NET

James Clark of Silicon Graphics fame hopes to tap the Internet market via Mosaic software page 90



NO MAGIC BULLET

The NIH's William Paul thinks AIDS research may have skipped a step page 108



AMEX' HIGH CARD

The new Optima card offers a generous grace period—but it will confront a horde of rivals page 32



COMEBACK KID

Could that be Paul Reichmann on New York's skyline? page 82



COFFEE TALK

Howard Schultz is opening a Starbucks café near you page 76

ment

TON OUTLOOK

s budget dilemma: Do the right
the political thing?

orporation

CKS ENTERPRISE

ee chain hits warp speed

Workplace

ELWORKERS' PLANTS

an't beat 'em, buy 'em

ce

OF THE REICHMANNS

estate family may be
ring a revival in New York

GIFTED, AND SITTING PRETTY

reet ace "Buddy" Fletcher

NTARY

ruble trouble: Short-term pain

WALL STREET

ron may be a winning ticket
e for Spelling?

o report on Bio-Reference

MENT FIGURES OF THE WEEK

Information Processing

18 TECHNOLOGY & YOU

Net-hopping via the World Wide Web

90 ENTREE TO THE INTERNET

Can Jim Clark score again by capitalizing on Mosaic, a user-friendly Internet software?

92 MCI IS WIRED FOR WIRELESS

It sees its chance to catch up at upcoming FCC auctions

Marketing

93 AVON LADY OF THE AMAZON

The queen of cosmetics is cleaning up in emerging nations

People

96 TURNAROUNDS FOR TEENS

James Hindman is keeping kids out of trouble—and making money at it

Science & Technology

107 DEVELOPMENTS TO WATCH

Cooler chip building, 3-D glasses with built-in TV screens, genetic off-switches, longer-blooming flowers

108 SHIFT IN THE AIDS BATTLE PLAN

Big clinical trials are being scaled back in favor of basic research

Personal Business

110 INVESTING: Reassessing small-caps

OUTDOORS: Bird-watching season

Features

6 UP FRONT

12 READERS REPORT

14 CORRECTIONS AND CLARIFICATIONS

15 BOOKS

115 BUSINESS WEEK INDEX

116 INDEX TO COMPANIES

118 EDITORIALS

A betrayal of the GOP's principles

The ruble's brutal lesson

It's power, not the way you talk

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Up Front

EDITED BY LARRY LIGHT & JULIE TILSNER

CAPITAL OFFENSES

HAVE VETO POWER, WILL TRAVEL

BOB DOLE, WHO KILLED OFF the lobby-reform bill, knows a lot about the special-interest-paid junkets the bill sought to ban. Among reform foes, Dole was the top trip taker in 1993, says Public Citizen, a watchdog group. Other happy recip-

JUNKET JUNKIES



Senators voting to kill lobbying reform who benefited the most from lobbyist-sponsored junkets in 1993:

	NO. OF TRIPS
BOB DOLE (R-KAN.)	12
DAVID DURENBERGER (R-MINN.)	11
BEN NIGHTHORSE CAMPBELL (D-COLO.)	8
CONRAD BURNS (R-MONT.)	6
SLADE GORTON (R-WASH.)	6
ERNEST HOLLINGS (D-S.C.)	6

DATA: PUBLIC CITIZEN

ients of corporate hospitality were 35 other senators who voted against the bill (table).

According to personal financial disclosure statements reviewed by BUSINESS WEEK,

Dole's 12 trips were underwritten by such interests as Archer Daniels Midland, Philip Morris, Ameritech, and Deere. Two of the jaunts took Dole, a 1996 White House hopeful, to Iowa, home of the first Presidential caucuses.

Other freebie-loving reform foes are Slade Gorton (R-Wash.) and Conrad Burns (R-Mont.), who face tough reelections this year. Ski and golf resorts were some of Gorton's destinations, paid for by insurance groups, among others. Burns's patrons include the Tobacco Institute and the cable-TV industry. Dole, Gorton, and Burns say their trips had zero to do with the bill, which they opposed because of its new disclosure requirements for lobbying by grassroots organizations. Dole says he avoids recreational trips. *Richard S. Dunham*

DIVERSITY

GLASS CEILING? WHAT GLASS CEILING?

CORPORATE AMERICA IS FRUSTRATING Labor Secretary Robert Reich. Labor Dept. officials say their study panel, created in 1991 to figure out ways to crack the "glass ceiling" stopping women and minorities from reaching busi-

TALK SHOW "We're not motivated to make more money. We all have too much already. We want to do good work."

—David Geffen, on why he, Steven Spielberg, and Jeffrey Katzenberg decided to form a new entertainment company

I-WAY PATROL

HOW TO MAKE ENEMIES ON THE INFOBAHN



FLAMED: Siegel and Canter

THE FLAMES ALMOST MELTED Martha Siegel's and Laurence Canter's PC screens. Last spring, in an affront to Internet etiquette that gained them national notoriety, the Scottsdale (Ariz.) husband-and-wife legal team flashed an ad for

their immigration-law practice to thousands of Internet newsgroup members. Outraged Netizens weighed in with a barrage of nasty messages. Canter and Siegel were unrepentant.

So now, they are bringing out a book telling others how to do what they did. *How to Make a Fortune on the Information Superhighway* is out in November from HarperCollins, which plans an ambitious first printing of 100,000 copies. The publishing house says it has already been bombarded with fire from enraged cybernauts.

But Canter and Siegel don't care, saying they've loaded of business from their Internet ad, and others should benefit from their example. "It's legal, it's valid, and it's moral," says Siegel.

shows, says a commission official, is that companies relied on supplying the grist for a full-blown federal discrimination probe. In fact, the commission's questionnaire form study is rather mushy. It didn't inquire how many females and minorities have gotten promotions, asking instead just for general policies.

Some no-shows say the \$738,000-per-year commission did a bad job contacting them. Deloitte & Touche says it believed the commission changed the hearing date the last minute. (McGraw-Hill, publisher of BUSINESS WEEK, missed the hearing but did provide an outline of policies.) Others had different explanations for not appearing. "We don't have the staffing for this," says Catherine Conroy, a spokeswoman for Donaldson, Lufkin & Jenrette. *Christina Del Voe*

REALITY CHECK

KILLING THE SUPERFUND OVERHAUL was a boon to business, say Republicans. Superfund has been hobbled in its mission to clean up hazardous-waste sites by lawsuits from companies wrangling over who should pay for the cleanup. Republicans argued that the leg-

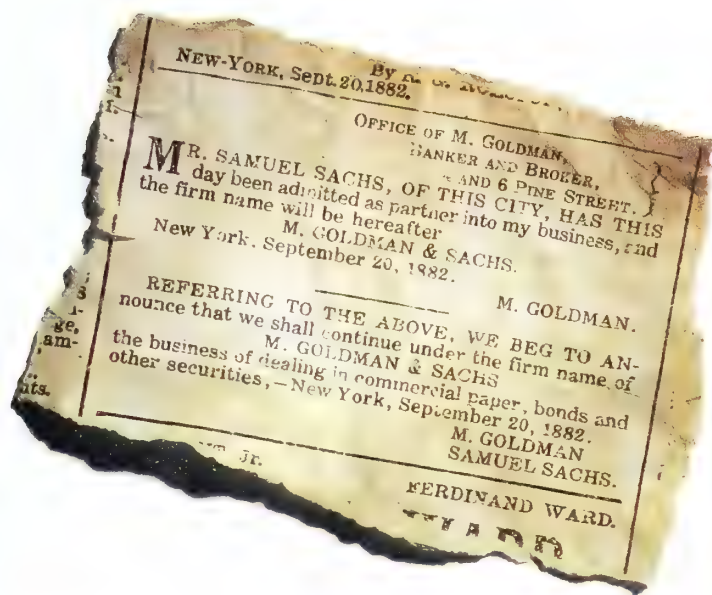
islation backed by President Bill Clinton was flawed in several ways, such as keeping overly stringent rules on cleaning up groundwater. Republicans, who hope to be in control of Congress next year, say they can get a better deal for business then.

IN REALITY, the bill's death will be costly to business. Whatever its flaws, it had the virtue of ending many disputes over who is liable—saving up to \$1 billion a year in reduced litigation and cleanup costs. Companies now have to keep shelling out for

at least another year. And industry lobbyists are doubtful the fragile coalition of environmentalists, insurers, and manufacturers behind this bill can do any better under Republicans, who iced it in an anti-Clinton vendetta. Why would legislative gridlock vanish in 1995? *John Carey*



VEXED: Bob Reich



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our firm well for 125 years.

Up Front

AFTERLIVES

OVER-THE-COUNTER INTELLIGENCE

THIS SPY HAS COME IN FOR the gold—or so he hopes. William Colby, director of the CIA in the 1970s, has just launched a biweekly foreign affairs newsletter for CEOs. For an annual subscription charge of \$445, the *Colby Report for International Business* dishes up “inside—and I mean inside” business intelligence. Example: a warning not to invest in Venezuela because of a possible coup.



COLBY: Scoops from a spook

But don't expect peeks at top-secret reports. Colby, still based in Washington, cut his ties to the CIA when he left

in 1976. “I haven't seen a secret document since then,” he says. What readers get are Colby's assessments of world affairs, taken from things he reads and people he talks to around the world. “The key to modern American intelligence is no longer the spy business,” says Colby. “The challenge today is to assess information and tell us what it means.” He won't say how many subscribers he has signed up.

Besides publishing, the former chief spook does some international business consulting, practices law, and is a director of the \$50

million Vietnam Frontier Fund, which invests in new business ventures there. But Colby, 74, hasn't put the spy biz behind him entirely. Activision Inc., a Los Angeles interactive-software company, has recruited him to develop a spy vs. spy CD-ROM game to be released next year.

Amy Borrus

THE BIG PICTURE

PERKS' POPULARITY

Part of the executive lifestyle is corporate benefits. But a recent survey of 254 companies shows some perquisites are waxing in use, others waning. A sampling:

COMPANIES THAT PROVIDED:
'92 '93

MOBILE PHONES
36% 61%

PAYD PARKING
22% 40%

PLUS MEMBERSHIP
45% 50%

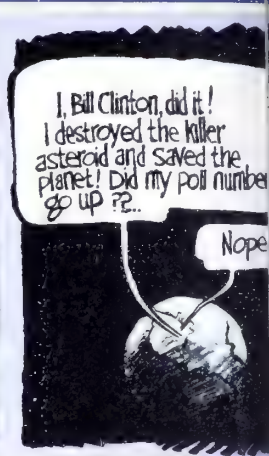
COMPANY PLANE
25% 18%

DEPENDENT LIFE INSURANCE
55% 22%



DATA: LUGGERS & LYBRAND

DRAWN & QUARTERED



TAXING MATTERS

WHAT'S THE BLUE BOOK ON BIG BLUE?

JUST HOW MUCH IS A USED computer worth? That hard-to-answer question is at the center of a tax dispute between business and local governments around the country. In 38 states, localities levy taxes on business equipment.

For computers, many companies are arguing in court that usual depreciation methods don't work because the rush of new technology ren-

ders their models outmoded, they argue, worth less. Says Amy Eisenstadt, director of state tax research at KPMG Peat Marwick: “A lot of companies have old computers on their books.”

The differences between computer values can be \$2

Overtaxed Computers

These companies sought lower tax assessments on their computers, saying newer models made them less valuable.

COMPANY/ TAXING JURISDICTION	REDUCTION SOUGHT
IBM CREDIT Pulaski County, Ark.	\$1.75 million
COMDISCO Harris County, Tex.	\$900,000
TELECOMMUNICATIONS INDUSTRIES Fairfax County, Va.	\$800,000

DATA: COURT RECORDS, COMPANY REPORTS

ting. In Pulaski County, Ark., the assessor put a value on three computers leased to IBM by IBM Credit at \$7.6 million. IBM, using prices gleaned from trade publications, claimed the value was actually \$5.85 million. That would translate to a tidy yearly savings of \$22,000.

So far, the court records are mixed. Pulaski County won by arguing that no market exists to cover the fair-market price of every computer. Yet in Jefferson County, Colo., the court accepted IBM Credit's lower valuation of the IBM 3090 leased to Adco Coors.

BABY BUSTERS

'BUT MY CUFFLINKS AND NOSE RING MATCH!'

TURNING DOC MARTEN FANS into wing-tip wearers is a challenge for such major employers as American Express, Sears Roebuck, Coca-Cola, and AT&T. They are using consultants to show sartorially deficient Generation X hires the do's and don'ts of corporate dress.

“There is a more relaxed attitude” toward professional attire among twenty-somethings, laments Kim Jasmin, manager of teller development at Chase Manhattan Bank.

Among young men, consultants find problems with wrinkled shirts, crumpled suits, and obnoxious ties—featuring, in one instance, Tweety Bird and Sylvester. Among young women, it's too much makeup and too-short

skirts. (The standard: anywhere from one inch above the knee to midcalf.)

Further complicating this are the new casual Fridays at workplaces. Says Genae Fields, president of Image One International in Houston: “There's a big difference between khakis with a sports shirt and cutoffs with a tight T-shirt.”

Kate Murphy



ON THE JOB: Grunge-free

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LISTEN UP, APPLE

Regarding "Spindler's Apple" (Cover Story, Oct. 3): As founder and publisher of *MacWEEK*, I've watched Apple's fortunes ebb and flow. Let me offer some advice:

Focus on strengths. The Macintosh became the bellwether publishing workstation because it was the only solution that combined PageMaker, PostScript, and LaserWriter. Today, Apple has a 90% market share in electronic publishing. That's strength. Everyone agrees that the next step in the evolution of communications is multimedia. Seven out of 10 multimedia titles are created on the Mac. That's dominance.

Forget the past. Microsoft Corp. has skillfully leveraged its applications business to cogently make Windows a business standard. Trying to win the game at this stage with old-fashioned virtues of power and speed is well-nigh impossible.

Embrace the future. Every successive hardware generation holds a promise for new players. In the late 1970s, Centronics dominated printing. Then came daisy wheels and Diablo/Qume. Epson Corp. was the dot-matrix king when Hewlett-Packard Co. showed its first LaserJet. Similarly, desktops are going the way of the mainframe. Apple has Newton. No matter how poorly received, that's the future. Apple should cancel some of its Super Bowl advertising spots and build the next Adobe, Quark, and Macromedia for this innovative platform.

Michael Tchong
San Francisco

In your article on Apple, you say Spindler took "the knife to sacred perks—the day-care center and the fitness centers.... In short, Apple has finally gotten serious."

But seriously, a corporate on-site day-care center need not be a drain on busi-

ness. Day-care centers can be operated at a break-even budget. And they are an important advantage in the competition for talented people.

Carola Endicott
Weston, Mass.

A HARDER LOOK AT 'SOFT MONEY'

You may describe them any way you wish; however, "soft dollars" sounds like a euphemism for payola ("Dangerous Liaisons," Finance, Oct. 3). The practice should be stopped.

Michael N. Cavaluzzi
Fox Point, W.V.

EASY FIXES FOR THE ENERGY CRUNCH

Your article "Soaring oil imports now could hobble the U.S. later" (Economic Trends, Oct. 3) is right on track because the story shows how ineffective the country's federal energy pol-

FOLLOW UP

"Desktops are going the way of the mainframe. Apple has Newton. No matter how poorly received, that's the future."



cy has been in reducing oil imports.

A better energy policy would first consider what we have—namely, abundant supplies of coal, natural gas, and uranium for nuclear power plants. We are running out of crude oil, and significant use of other energy sources takes years or decades away.

Next, we determine what each energy user should use. Electricity-generating plants would be nuclear or coal-fired, because we have abundant supplies. To conserve oil and natural gas for other uses, homes and buildings would use electric heating. Cars and trucks would use compressed natural gas or battery power. Trains on bus-

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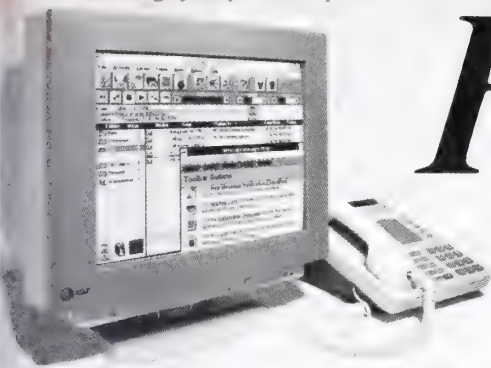
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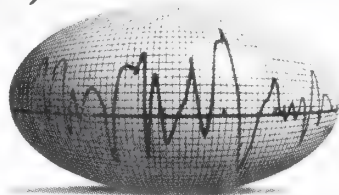
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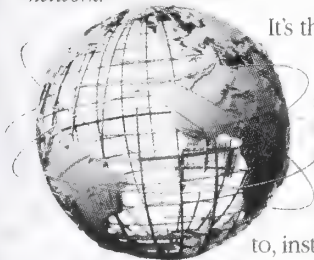
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Readers Report

CORRECTIONS & CLARIFICATION

"You're no kid, and that's not acne" (Personal Business, Oct. 3) should have given the hometown of Marlane Fairlie as Jacksonville, Ala.

routes would use electricity, and would use oil products.

Robert G. Carpe
Naples, Fla.

AMERICA VS. JAPAN: TAKE OFF THE GLOVES

For a long time, we have taken a defensive position rather than the offensive in trying to settle trade matters with Japan. As a result, the complexities and the roadblocks we ("Why it's time for a showdown with Japan," Top of the News, Oct. 3) are our own doing.

Why wait for Japan to make its promises again? Impose the trade restrictions of the "301 law" immediately. Let Japan come back with actual market data, not just promises, in order to show that their markets are truly open. Only then would the restrictions be removed.

Michael R. Adara
Bridgewater, N.J.

LEADERSHIP, DEC STYLE

Wait. Let me get this straight. Will Digital Equipment Corp. employees not expect salary increases for the foreseeable future and while thousands of them have lost, or will lose, their jobs as a result of mismanagement, two members of senior management have received 18% and 35% increases ("Payoffs to downsized DEC," Up Front, Oct. 3)? These guys know how to lead, or what?

S. P. Johnson
Northborough, Mass.

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r conditioning. An AM/FM cassette stereo. Airbag. Anti-lock . Equipment varies from model to model, but suffice to say it's off you're looking for. And perhaps even more importantly, Value

models allow you to avoid the you're not looking for. Namely, relatives. Heck, pushy ads, too. , let's say your brother-in-law t you a deal on a car. Let's say

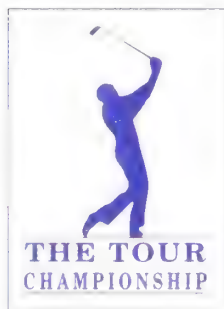
not that fond of ol' Curtis or Ray Bob or Gus. What do you do? hy not get a better deal yourself? Then, for once in his life and maybe he'll clam up.



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P
ing End of Canada and the Stakes for America
ing Lamont
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THE NATION, VISIBLE

While Americans have been transfixed by the spectacle unfolding in Haiti, few have paid notice to the potentially far more dramatic drama being played out north of the U.S. border. On Sept. 26, Parti Québécois leader Jacques Parizeau was elected as Premier of Quebec. In keeping with the PQ's goal of making Quebec an independent nation, the room had

been ripped of the Canadian flag. "Sound the alarm call," Parizeau said to his new Cabinet. "We are already a country. Let's raise our hearts and our voices and proclaim it to the world."

is perfectly timed up: *The Coming of the New Canada and the Stakes for America*, Lamont argues compellingly that it's high time Americans heeded Parizeau's reveille. Lamont, a *Time* foreign correspondent and later managing director for Canadian Affairs at the Americas Society, once predicted Canada could "splinter into more states before century's end." In the book's sequences for the U.S., he shows, the enormous.

starters, the world's largest bilateral trade relationship would be disrupted. In 1993, total U.S.-Canada trade exceeded \$260 billion, a figure larger than the gross national products of most nations. That figure suggests, the two economies are deeply intertwined. All the Big Three auto makers, for example, have massive assembly plants in Canada, and most of the cars they make are sold in the U.S.

Canada and Quebec divorce, Lamont speculates, the thousands of U.S. companies doing business in Canada—

including Xerox, IBM, and such retailers as Sears Roebuck, Kmart, and Gap—could face a "nightmare" of conflicting accounting practices, laws, and trade rules. But there's much more than trade at stake. As a member of the North American Aerospace Defense Command (NORAD), Canada plays a key role in U.S. national defense. A breakup would undermine that alliance. And Canada

would almost certainly lose its membership in the Group of Seven.

Because Quebec and English Canada have been arguing so long, U.S. citizens tend to dismiss the idea of a breakup. But, as Lamont contends, Canada has never been in greater danger of coming unraveled. In the past four years, two major efforts to resolve Quebec's grievances by amending the constitution have collapsed, leaving Canadians

exhausted and embittered. Polls show that 40% of Quebec's population favor independence. Now that the separatists are in power, they have an unprecedented opportunity to promote their cause, though PQ members concede that their 1995 referendum on independence faces an uphill fight.

Lamont believes that eventually the independence drive can succeed, and he provides a dramatic, if not entirely plausible, account of just what might happen. In his scenario, Quebec declares independence on June 1, 2000, in a ceremony witnessed by "a cluster of ill-at-ease junior envoys from Ottawa, London and Washington." Within weeks, Quebec and English Canada begin negotiations over everything from the division of Canada's debt to the status of Canadian military installations on Que-

bec soil. But with English Canada seething, the talks degenerate into bickering and finally collapse. Meanwhile, Quebec tries to fend off the demands of its native peoples, who lay claim to most of Northern Quebec, an area two-thirds the size of Alaska that is home to Hydro-Quebec's huge power plants.

During Quebec's second summer on its own, frustrations explode into violence. A small band of natives blows up one of Hydro-Quebec's largest plants, blacking out much of Montreal and parts of the Northeast U.S. Mounting tensions between the sovereigntists and Montreal's embittered English-speaking residents spark riots near McGill University. The U.S. Army is quietly invited in to restore calm—but not soon enough to prevent a rout of the Canadian dollar and the Toronto Stock Exchange.

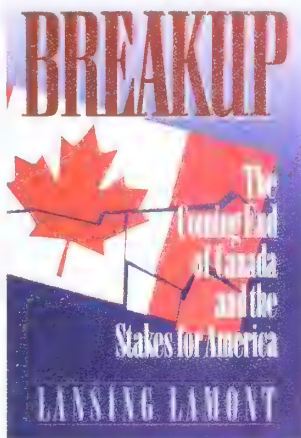
When Canada and Quebec finally hammer out a settlement, it's just the start of an agonizing reappraisal of what Canadians already call the Rest of Canada (ROC). Its Atlantic Provinces cut off from the remainder of the country, ROC is unwieldy—and soon proves unworkable. Ontario and the wealthy western provinces are no longer willing to prop up depressed Atlantic Canada. Other provinces, fearing dominance by Ontario, which accounts for over half of ROC's GDP, break up into regional alliances. Some—led by Alberta and British Columbia—apply to join the U.S.

It's easy to poke holes in Lamont's scenario. The bloody riots he envisions seem especially improbable. And in the event of a breakup, both Quebec and ROC undoubtedly would do everything possible to minimize disruptions and maintain close trade ties with the U.S. But Lamont's goal is to get readers thinking about "what could happen in the worst of circumstances."

He's not alone in his speculation. Most of Canada's top think tanks are also publishing elaborate studies of what could happen—because a breakup, while unlikely, is no longer unthinkable. Even though some of his particulars may be off base, Lamont is right about the key point: Any divorce would prove enormously complicated and painful for all of North America.

BY WILLIAM C. SYMONDS

Symonds is *BUSINESS WEEK's* Toronto bureau manager.



LAMONT'S DIVORCE SCENARIO FEATURES A ROUT OF THE CANADIAN DOLLAR AND BLOODY RIOTS

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EDITED BY STEPHEN H. WILDSTROM

AN EXPRESS LANE FOR THE INFOBAHN

If you're among the tens of thousands of Americans who have jumped aboard the Internet in recent months, you may be wondering what all the excitement was about. Global E-mail can be very useful, but the "newsgroups" are filled with noisy nattering. And while vast resources, from U.S. Supreme Court decisions to library catalogs to government purchase proposals, are available, they're hard to find and harder to use.

There's another part of the Net, the World Wide Web, that gives you a hint of what the multimedia Information Superhighway of the future may look like. But you can't explore it using a typical dial-up connection provided by a company such as Delphi Internet. A special type of dial-up service is needed to get access to the Web and these connections have been very difficult to set up.

WEB SPINNERS. Until now, New products hitting the market make full use of the Internet no harder than opening an account on CompuServe. NetCruiser from Netcom (800 353-6600) and Internet in a Box from Spry (800 777-9638) can have you up and running in a few minutes.

First, a word about the Web. Spiffy graphics and fancy formatted text give the Web a distinctive look. Audio and video clips are also turning up. But the Web's real power is revealed when you click on an underlined word or phrase. Like similar underlining in Windows help screens or in HyperCard on the Macintosh, a click gives you a screen

of related information. But on the Web, you may zoom off to a computer anywhere. For example, I travel electronically to the University Consortium for Atmospheric Research in Boulder, Colo., to look at weather maps. A couple of clicks and I'm at the Univer-



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sity of Michigan, checking out the current Southern California forecast.

The Web is growing fast, with dozens of new sources of information—often little more than a picture and a description of things under development—coming on line daily. The Web has begun attracting business interest, with high-tech companies dominating. For example, Bernard Hodes Advertising of New York has begun a service

called CareerMosaic, which posts information on employment opportunities with such companies as National Semiconductor Corp.

NetCruiser and Internet in a Box both allow you to browse the Web using improved versions of the free Mosaic program, which was developed by the National Center for Supercomputing Applications. Mosaic works best with a high-speed direct connection to the Internet, and you will need at least a 14,400-bit-per-second modem for tolerable performance. Both packages also include a set of other Internet utilities, such as the telnet program used to log in to remote computers. Internet in a Box also throws in a special edition of *The Whole Internet Catalog* by Ed Krol, which doubles as a user's guide to the software.

FREE—SORT OF. Netcom and Spry get similar results with different approaches. Netcom gives the software away but requires you to use it to connect—using local phone numbers in major cities—with its California computer system. Spry's software lets you either log on to SprintLink (for \$8.95 a month plus \$8.95 an hour) or establish an account with the Internet vendor of your choice. I used Internet in a Box with an existing account at Maryland's Digital Express Group, and the software comes with a list of 100 or so other sources.

Setting up service independently is harder but can offer significant savings.

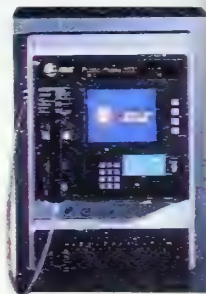
For now, the Web remains a construction site. Sometimes clicking on a hypertext link will launch you into hyperspace (though both programs provide easy ways to get back). Many sources seem to promise more than they deliver. But for a glimpse at the information network of the future, the Web is worth the trip. **S.W.**

BULLETIN BOARD

ADVANCED SERVICES

PAY-PHONE UPGRADES

Why don't the keyboard-equipped phones at airports provide the fancy services they promise? asks Gil E. Gordon of Monmouth Junction, N.J. AT&T says that's because it began installing



the Public Phone 2000 in 1992 without FCC approval for such uses as E-mail. For now, you can plug a laptop or fax into the data jack and use the unit as a telecommunications device for the deaf (TDD). But picking other items from the on-screen menu produces a message saying that the feature is unavailable.

AT&T finally got clearance this spring. A spokesman says that in coming months the services will gradually be introduced to the 4,000 phones.

LOBBYING EXPENSES

TAX SOFTWARE

No niche, it seems, is too small for software entrepreneurs. The 1993 tax act created complex rules restricting the deductibility of lobbying expenses. Washington's Gnossos Software (204-463-1200) is offering Keep in Touch: Lobby Tax software for Windows to help companies comply. But only heavy hitters will be able to afford it: The program fetches a cool \$5,000.

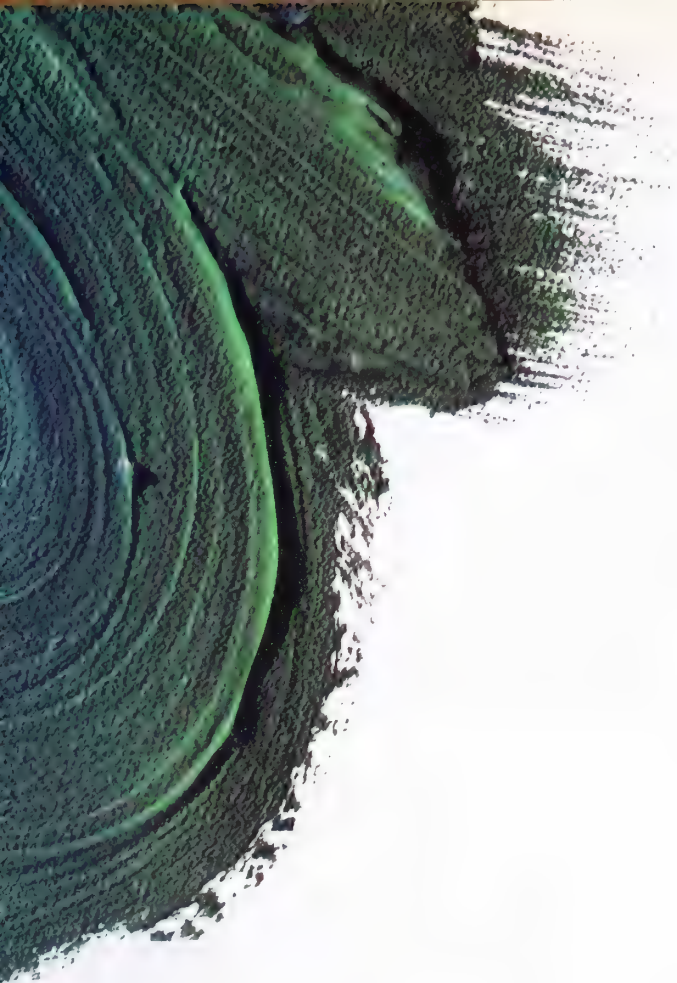
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BY ROBERT KUTTNER

THIS BUDGET 'CONTRACT' IS NOTHING MORE THAN VODOO II



WHY ARE House GOP candidates yoking themselves to a plan that supply-siders have already tried—to disastrous effect?

For the first time in memory, Republican House candidates are campaigning as a national ticket, pledged to carry out a common program—one that has attracted mainly ridicule. Over 300 Republican House candidates have sworn allegiance to House Republican leader Newt Gingrich's "Contract with America," a 247-page, seven-year master plan for the federal budget that is all too reminiscent of the voodoo budgeting of the early Reagan years. Gingrich, over-eager for victory, has handed his opponents a sword.

The plan calls for a balanced federal budget by the year 2002, coupled with new tax cuts. If that sounds contradictory, it is. According to the Congressional Budget Office, \$743 billion in tax increases and spending cuts would be needed to balance the federal budget over five years. But the House Republican plan widens the deficit with new tax cuts and spending increases totaling some \$279 billion; it offers offsetting spending cuts of only \$221 billion. Thus, the bottom line is off by over \$800 billion.

In the early 1980s, supply-siders forecast that Reagan's tax cuts would so stimulate savings and investment that increased tax revenues would more than compensate for reduced tax rates and that the federal budget would be in balance by 1984. But net savings rates actually fell because federal borrowing consumed private savings. Overall investment rates remained at roughly historic levels, but the accelerated depreciation gimmicks of the 1981 tax law created a tax-shelter industry that steered many investments to economically inefficient uses.

CURTAIN CALL. Under Reagan, the annual federal deficit averaged over \$200 billion. When the curtain fell on the 1980s, the annual growth rate was a shade lower than in the feeble 1970s. The national debt had trebled. A structural annual deficit—that is, one rooted in the structure of the tax system—of about 5% had become chronic. The productive economy was hobbled by high real interest rates that were necessary to finance the escalating debt load.

You might wonder why Republican challengers would yoke themselves to such an assailable plan. One reason may be that the National Republican Congressional Committee reportedly told GOP challengers to endorse Gingrich's plan if they expected maximum fi-

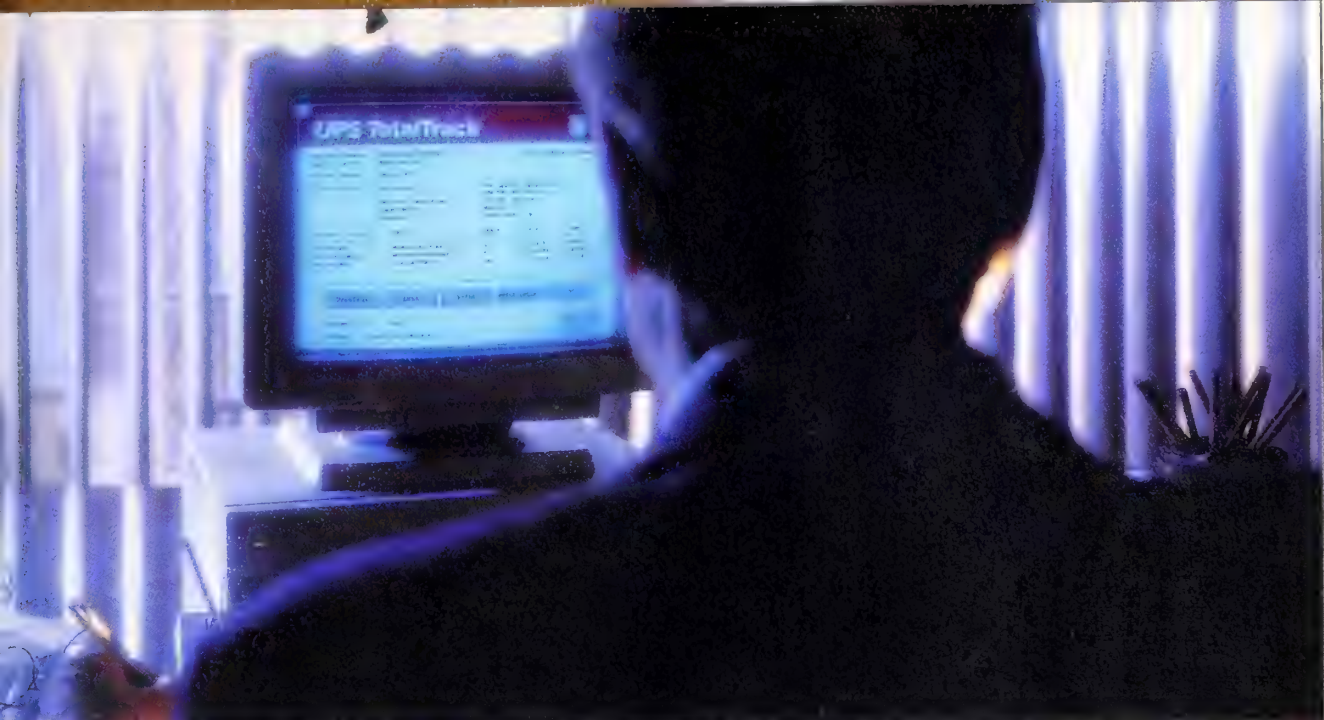
nancial help. Aside from being preposterous economics, Gingrich's Voodoo II is politically vulnerable. While the Clinton Administration has faltered on other fronts, the President has commendably cut the deficit, which has fallen from 4.9% of gross domestic product in 1992 to just 2.3% today.

Several influential conservative groups now constitute a powerful lobby against fiscal excess. Carol Cox Wait, president of the Committee for a Responsible Federal Budget and a loyal Republican, agrees that Gingrich's plan is a fiscal pipe dream.

HISTRIONICS? The Concord Coalition, likewise, a mostly Republican-led group of notables devoted to budget balance, dismisses the House GOP proposal as "little more than political theater." The Coalition's analysis faults the plan for "deceptive accounting," citing several fiscal time bombs which cynically front-load benefits and back-load fiscal costs. In its proposed expansion of individual retirement accounts (IRAs), interest earned would be perpetual tax-free rather than tax-deferred, as under present law. The revenue impact would be low at first but would compound over time. The executive director of the Concord Coalition, incidentally, is Martha H. Phillips, formerly the Republican staff director for the House Budget Committee.

The liberal Center on Budget & Policy Priorities, which seldom agrees with the Concord Coalition, offers a nearly identical analysis. Staff member Ellen Nissenbaum points to another example of hypocrisy. One of the proposed bills, "The Senior Citizens Equity Act," would offer old folks several new goodies, including a liberalization of the earnings limit for Social Security recipients, a repeal of the tax on Social Security income now levied on the wealthiest 13% of pensioners, and new tax benefits for private long-term care insurance. But buried elsewhere in the package are cuts in meals for shut-ins, in Medicare (which pays nursing-home costs), in Medicaid, and in SSI (supplemental security insurance). And if the balanced-budget requirement ever passed, Social Security would take the biggest hit.

Gingrich is evidently gambling that voters won't look closely at the fine print. But in pursuing such a strategy, Gingrich invites the Democrats to ask voters: Do you really want to put these people in charge of the federal budget?



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BY GENE KORETZ

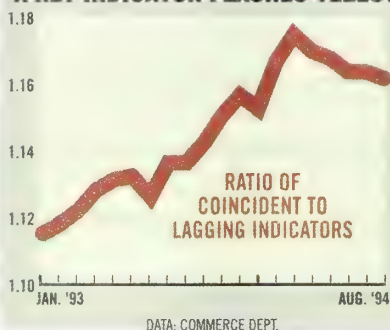
THE U.S. UPTURN IS MIDDLE-AGED

Economic doctors say "slow down"

Considering the U.S. economy's continued robust performance, it may seem premature to speculate on the next recession. Yet as economist David Hale of Kemper Financial Services Inc. observes, within a few short months, the current upswing will be older than five of the eight postwar expansions, and in April, it will enter its fifth year.

Moreover, though the index of leading indicators is showing renewed strength, a related omen is flashing yellow. The ratio of coincident to lagging indicators, which tends to fall as debt, interest

A KEY INDICATOR FLASHES YELLOW



rates, and labor costs start to pick up steam, has been weakening since March (chart). Since declines in this ratio have foreshadowed cyclical downturns by about 13 months on average (far earlier than the leading index), its continued weakness is hardly reassuring.

Like most of his fellow economists, Hale thinks the fate of the current business expansion rests on the Federal Reserve's ability to slow growth enough to contain inflation next year. The only two postwar upturns that lasted more than five years, he notes, both benefited from midcycle pauses that reduced capacity pressures and the need for further monetary restraint.

Several factors bode well for the Fed's efforts this time around, says Hale. Because the initial upturn was unusually modest, supply problems have only begun to appear. Consumer and business balance sheets are still healthy, so Fed tightening is unlikely to cause an outright spending collapse. And the global recovery promises to sustain U.S. exports and capital investment even as

housing and consumer spending slow.

While Hale is bullish about the expansion's staying power, he sees two wild cards. If the global upturn causes commodity prices to soar, the Fed could be forced to tighten more than it would like. And a move by the Clinton Administration to shift gears and opt for its own program of middle-class tax cuts in the runup to the 1996 Presidential election could roil the financial markets, with uncertain effects on the economy.

HEALTH PROGRESS HITS A SNAG

The flu and AIDS hurt longevity

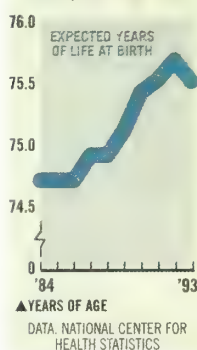
Americans who think of themselves as living longer and longer are in for a shock. The National Center for Health Statistics reports that U.S. life expectancy fell last year, to 75.5 years, from 75.7 years in 1992.

The good news is that this isn't the start of a trend. U.S. life expectancy, which was 68.2 years in 1950 and 70.8 in 1970, should continue to rise. But dips do occur occasionally, when outbreaks of infectious diseases such as influenza temporarily push up mortality rates. A flu epidemic was the culprit the last time life expectancy dipped, in 1980.

The bad news is that such dips could become a bit more common in future years. The reason is the rising death toll from AIDS. Young adults are the main victims of AIDS, and the younger the group affected by a fatal disease, the larger the impact on overall life expectancy. Last year, the combined effects of rising AIDS-related deaths and non-AIDS-related deaths at most age levels (probably related to two outbreaks of flu) were enough to cause life expectancy to decline again.

The Census Bureau has predicted that U.S. life expectancy at birth could exceed 82 years by 2050, a view supported by continuing declines in infant mortality rates and by improved care for many illnesses. Whether that view proves overly optimistic may depend on the development of an effective treatment for AIDS.

LIFE EXPECTANCY DIPS IN THE U.S.



AN ATLANTIC SPLT IN FISCAL POLICY

The U.S. eases as Europe brakes

Up to now, fiscal restraint has been the rule on both sides of the Atlantic. In the U.S., the combined effect of higher tax rates (in the face of robust growth) and big declines in federal outlays, particularly for defense, slashed the federal deficit from \$264 billion in 1993 to about \$200 billion in 1994. But in 1995, with no new major tax hikes in the wings and a sharp swing in defense cutbacks, the pendulum will swing away from fiscal drag. According to the Congressional Budget Office, fiscal policy will be essentially neutral next year.

By contrast, Western Europe intends to tighten the fiscal screws. Taxes are already slated to rise next year in Germany, Britain, Spain, and Sweden, for example, and Italy, Sweden, and Belgium are trying to cut social spending. Economists at J. P. Morgan & Co. believe that tighter budgetary policies will be enough to slice 0.8% off Europe's gross domestic product in 1995.

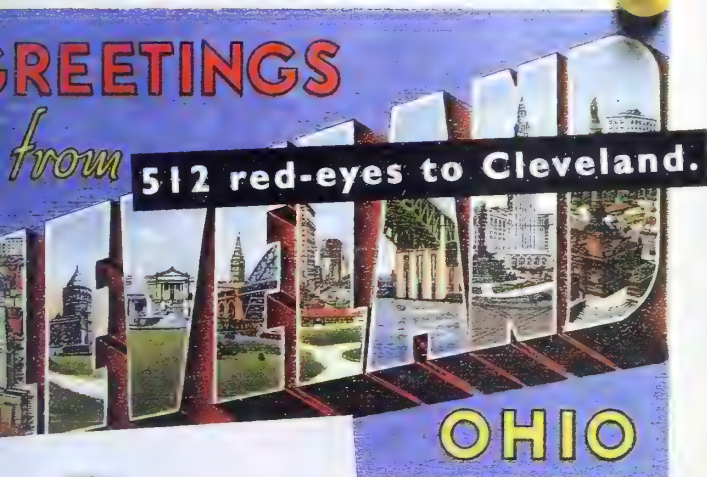
WALL STREET RIDES THE CYCLE

The bull thrives on young upturn

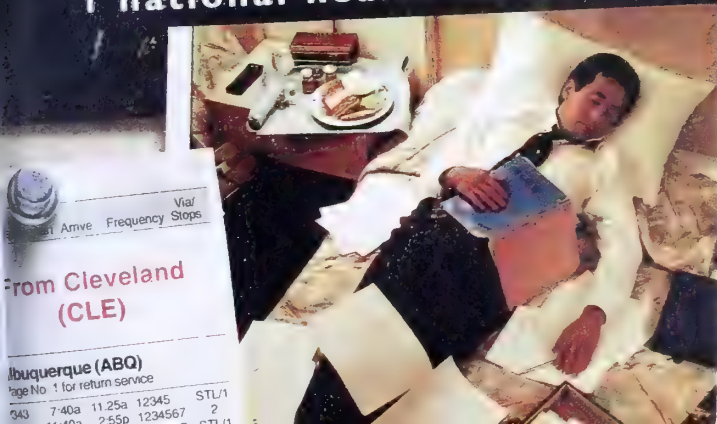
Stock market investors have a special interest in the staying power of the current U.S. business cycle. James Stack, publisher of the *Investech Market Analyst* newsletter, notes that in the past, stock market profits have been typically concentrated in the youth stages of a recovery.

By the time six of the eight postwar U.S. expansions had reached their peak points, reports Stack, stock prices had already posted at least 75% of their cyclical gains (from the market bottom during the previous recession to the peak prior to the next recession). And unless the current recovery lasts until 1998, its life is already half over.

If the Federal Reserve does manage to engineer an economic pause that refreshes, however, there's a fair chance that Wall Street can still buck the historical odds. Although stock prices underwent some unsettling corrections after the long expansions of the 1960s and 1980s hit middle age, notes Stack, they still had about 40% to 50% of their cyclical gains ahead of them.



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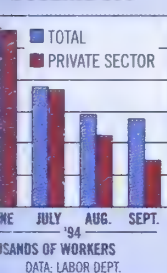
THE JOB MARKET IS SIMMERING, BUT IT'S HARDLY OVERHEATED

U.S. ECONOMY

Wall Street had been worrying all week about the September employment report. Amid recent signs that the economy might be too rambunctious for its own good, thus inflation-prone, the Street's anticipation of the data had the markets frozen with fear.

It was wasted worry. On Oct. 7, the Labor Dept. said for the second consecutive month, payrolls rose far more than the markets had expected. And despite the September drop in the unemployment rate, wage gains still show no sign that they are accelerating. More than that, growth during the past four months shows a clear pattern of slowing (chart).

JOB GROWTH IS COOLING OFF



The result: Both the stock and bond markets posted gains in the days following the job numbers, as fears of an imminent hike in interest rates by the Federal Reserve began to wane, as initial third-quarter earnings reports looked good, and as the situation in Iraq appeared less explosive, at least for now.

The employment numbers are another piece of evidence indicating that the economy's peak growth rate in this expansion is now in the past, because the Fed's rate hikes are beginning to slow the economy.

However, a big question remains: Is the economy slowing enough to push growth down to the 2.5% pace—or just about—that will mollify the Fed? For now, based on September job data, another rate hike at the Fed's next 15 policy meeting still looks likely.

BE SURE, job growth remains healthy. Industries added 239,000 workers to their payrolls last month, and employment gains in both July and August were revised by the Labor Dept. lifted July's tally by 30,000, to 290,000, August's total by 71,000, to 246,000. Only a solid economy posts gains like that.

However, the trend toward smaller job gains is unmistakable. During the third quarter, businesses added an average of 258,000 jobs per month, well below the 345,000 in the second quarter. Overall hours worked, a measure that combines job gains and the workweek, rose at a scant annual rate last quarter, from a 6.6% pace in the second quarter. That's a signal that third-quarter economic growth will be well below the second quarter's 4.1% pace.

Moreover, the September increase was overstated. Government employment jumped by 65,000, mostly reflecting the temporary hiring of election workers for primaries in several states. That boost will turn into a bust in October. Private-sector employment alone rose by only 174,000 last month, the least since January. The job slowdown since June has been even steeper in the private sector than overall.

Another reason to expect more moderate job gains in coming months is the way Labor accounts for the workers hired by new businesses. This adjustment, which is purely an estimate that the government adds to the job count, by itself contributed 155,000 jobs to the September increase. And this "plug factor," as economists call it, has been exceptionally large in recent months.

However, that doesn't square with the Commerce Dept.'s index of business formations, which has declined 3.5% since March. That drop suggests that Labor's adjustment is too big and that it will have to be lowered in coming months.

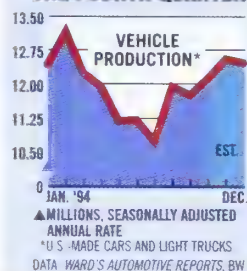
AS IN RECENT MONTHS, the service-producing sector generated the lion's share of the September job gains, led by retail trade, transportation, and business and social services. For the second month in a row, though, the increase in temporary help services was less than its monthly average during the past year, a sign that many temporary workers are finding permanent jobs.

Among goods producers, construction racked up the biggest payroll increase last month. Builders added 19,000 workers, after no gain in August, but you have to wonder if job increases of that size can continue in coming months. Construction activity weakened sharply during the third quarter, as inflation-adjusted spending in private construction dropped a steep 1.5% in August, after a 1.1% decline in July.

And manufacturing, despite its dynamism of late, remains happy to add jobs in dribs and drabs, letting surging productivity account for its output growth. Factory employment dipped slightly in September, even though the auto industry put on 6,000 new workers.

In fact, Detroit stands ready to give factories—and the economy—a lift in the fourth quarter (chart). Based on the

DETROIT WILL LIFT THE FOURTH QUARTER



auto industry's unit production schedules, BUSINESS WEEK estimates that seasonally adjusted output of U.S.-made cars and light trucks this quarter will jump at an annual rate of 36% from the third quarter. After a slight decline in September, to an annual rate of 11.8 million, production will rise to 12.1 million in October and to 12.6 million in November.

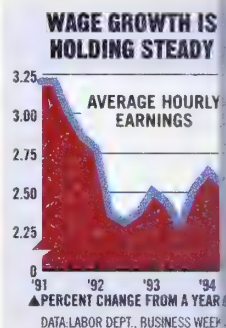
DESPITE THE MODERATION in payrolls, the financial markets' inflation bears did have the September drop in the unemployment rate to point to as a sign that labor markets are tightening up, and that wage pressures cannot be far behind.

The jobless rate fell from 6.1% in August to 5.9% last month. That's close to the level that many economists, including those in the Clinton Administration, believe is the minimum rate that the economy can bear without setting the wage-price spiral in motion.

Stronger labor markets partly explain why consumers are more confident in taking on debt. Consumer installment debt outstanding soared by \$11.2 billion in August, and growth in the past half year has been the largest on record. 1994's additions are partly exaggerated, though, by "convenience" use of credit cards, wherein balances are quickly paid off. Revolving credit exploded by a record \$6.9 billion in August. The Fed will try to measure convenience use in an upcoming report.

However, the jobless rate may well be understated. As economists at Merrill Lynch & Co. point out, there is a glaring inconsistency between the declining jobless rate for adult men and the flat trend in the male employment-to-population ratio, which should be rising if the unemployment rate is falling. The discrepancy suggests that there is still a large pool of potential workers who are not counted in the labor-force data.

Even with the drop in the jobless rate, wage growth remains tame. Average hourly earnings rose 0.3% in September, and in the third quarter, they stood 2.6% ahead of last year, with no sign that wage growth is about to break out of the 2.3%-to-2.6% band it has been in for the past three years (chart). Besides, productivity in manufacturing has been growing so strongly that factory unit labor costs are still falling.



That's hardly cause for worry. Of course, Wall Street will always find something to fret over, especially the bond market, where inflation can erode long-term returns. But if it was signs of inflation that the Street was looking for in the September job numbers, there were none. The markets will just have to find them somewhere else.

EUROPE

BRITAIN KEEPS WRESTLING INFLATION

Britain, the first European economy out of recession, is confronting the conflicting goals of solid growth and low inflation. The economy seems to be slowing, but perhaps not by enough to placate the Bank of England.

Inflation fears were aroused by an unexpectedly large 0.7% jump in the prices of fuel and raw materials in September. Such business costs are up 5.7% from a year ago. However, falling labor costs have offset these pricier supplies. Unit labor costs in manufacturing fell 0.8% in the three months ended in August. As a result, prices of goods leaving the factory gate rose 0.2% in September,

and only 2.4% in the past year.

So, too, in September, retail prices rose just 0.2% for all items and for the underlying rate, which excludes mortgage-interest payments. And while higher rates have pushed up mortgage payments this year, the underlying rate is up just 2% from a year ago—a 27-year low (chart).

Slack domestic demand in a fiercely competitive market has prevented companies from raising prices. In August, retail sales fell 0.4%, and factory output dropped by 0.3%. Part of the output decline was caused by an oil-refinery fire, but other industries also reported

production drops. That means the economy likely did not grow as fast in the third quarter as in the second, when growth hit a 4.6% annual rate—even with April's tax hike.

The big inflation worry is that any slowdown will be temporary. Confederation of British Industry survey suggests that factory output will bounce back this quarter. Both exports and imports hit new highs in July. And unemployment dropped by 28,000 in September, pushing the jobless rate to 9.1%.

Given Britain's two years of growth, its dilemma is not unusual. The Bank of England has already moved preemptively against inflation with a half-point hike in short rates on Sept. 12. If more data point to renewed strength, though, don't rule out another hike by yearend.



To handle the blizzard of reservation calls during the busy season, Taos Valley Resorts had to ask many potential customers to hang on. Unfortunately, too many simply hung up.

Sprint Business created a real solution: Enhanced 800SM Service instantly transferred calls to Taos operators at other sites, so customers got through quickly. And reservations jumped 30%.

We've also helped put their marketing communications in peak condition with SprintFAX[®]. At the push of a button, they now send timely promotions and snow updates to more than 200 newspapers and travel agents simultaneously. It gives Taos Valley Resorts a real edge over the competition.

No matter what business you're in, Sprint Business can help you turn communications technology into a powerful business tool. One that can help make you more profitable. And isn't that why you're in business in the first place?

Find out how we can help your business do more business. Call 1-800-598-5000.

When Sprint Business took our customers off hold, business snowballed.

India Hatch
President
Taos Valley Resort Assn.



REAL BUSINESS	REAL PROBLEM	REAL SOLUTION	REAL RESULTS
Taos Valley Resort Association	Sales lost due to busy reservation lines	Calls re-routed instantly to available operators	30% more reservations boosted profits



IS THIS AMEX' TRUMP CARD?

Maybe. But Optima True Grace is in for a tough slog

Finally, Harvey Golub's American Express Co. is taking shape. Gone is the Shearson brokerage and Lehman Brothers Inc. investment bank. Gone, as well, are 4,000 employees and more than \$1 billion in annual expenses. On Oct. 5, the financial-services giant took its most dramatic cost-cutting measure yet, announcing layoffs of up to 6,000 employees and the closing of three card-processing centers.

Now, with much of the cost-cutting behind him, Golub confronts the real challenge: rebuilding AmEx' languishing consumer-card empire, the key to restoring the sort of profit growth that AmEx enjoyed effortlessly, it seemed, through the 1980s. Golub's first step: the Optima True Grace Card, introduced Sept. 6.

LITTLE CHOICE. Don't underestimate this piece of plastic, AmEx' first new card in seven years. It's at the heart of the CEO's plan to market credit cards for the first time to consumers other than AmEx members—and, in the process, to extend the company's card franchise.

It's a strategy that could remake AmEx, but it's not for the meek. The credit-card market is jam-packed with rival products, most of them packaged with rebate offers, low interest rates, and other familiar bells and whistles. AmEx will fight for interest income with some 6,000 different cards from Visa issuers alone, going head-to-head with the likes of Citibank and AT&T. Already, some consumers feel overwhelmed. Says Sandra Morris of San Francisco: "We just use the Visa or MasterCard to get

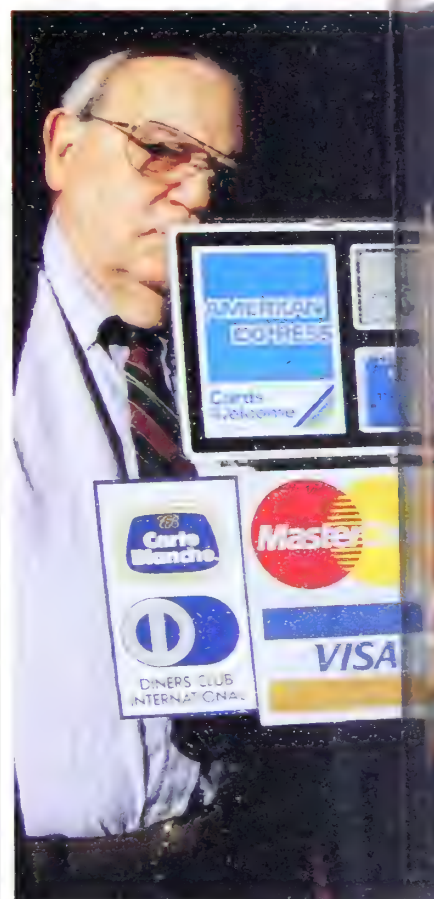
mileage. We feel we don't need any more cards."

Golub has little choice but to entice consumers with yet another card. "Revolving credit is where American Express' salvation lies," says Robert McKinley, president of Ram Research Corp. "If they want to survive in the consumer market, they've got to get involved in revolving credit cards." At Travel Related Services (TRS, AmEx's card and travel-services unit), net income jumped 259% last year from cost-cutting, to \$895 million, and its corporate and international charge businesses are growing. AmEx depends on its TRS unit for 65% of profits.

In three years, though, AmEx has seen its total share of worldwide charge volume shrink to 15.9% from 18.8%, Ram Research estimates. And the number of green, gold, and platinum consumer cards in use has declined steadily since 1991 and should drop another 3.5% this year, to 11.1 million, estimates analyst Guy Moszkowski at Sanford C. Bernstein & Co.

Golub brushes aside such concerns, pointing out that his remaining "members" are charging 10% more than they did three years ago—bringing in higher fees from merchants. "We think there will be significant growth in charge cards," he says.

Analysts like the Optima True Grace because it offers an identifiably new advantage. It lets consumers avoid paying interest on new purchases for 25 days, even if there's a balance on the account. Other major card issuers allow a grace period only when accounts have no outstanding balance. Ram's McKinley calculates that a typical Visa consumer, with a \$1,700 balance, \$2,500 per year in new purchases, and an interest rate of 17.38%, would save \$45 annually by using True Grace. "For some cardholders, it's a desirable option," says McKinley. "Grace periods have been a sacred area. Now AmEx is challenging it."



The Play

How American Express

**AMERICAN EXPRESS
TRUE GRACE OPTIMA**

INTEREST RATE: 7.9%
for six months, then
prime rate plus 8.75%

GRACE PERIOD: 25 days
on each new purchase

**AT&T
UNIVERSAL CARD**

Prime rate plus
9.9%

No grace period
account is paid

Certainly, much is at stake: Golub says that if Visa issuers were to match Optima's grace period, Visa card holders in the U.S. would save \$2 billion a year. True Grace could, with AmEx's marketing heft, spark a price and features war in the \$562 billion industry.

The problem: True Grace's advantage is hard to market. Next to, say, the General Motors/MasterCard discount on a new car, a generous grace period remains a difficult feature to communicate. To do so, Golub will spend \$10 million this year in advertising. But "there aren't people out there clamoring for

AMEX' RIVALS INCLUDE
6,000 CARDS FROM
VISA ISSUERS ALONE

lefield

t card stacks up

SSIC
CARD

plus 9.4%

&T's

DISCOVER

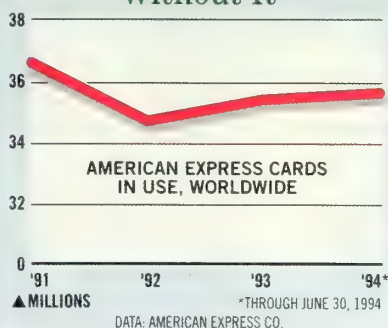
Prime rate plus 8.9%;
maximum, 19.8%

Same as AT&T's

DATA: COMPANY REPORTS

They don't know that they don't it," says Michael Auriemma, a bury (N.Y.)-based consultant. Over, any savings from the grace d could be wiped out by a compet-product with lower interest charges. hEx has to figure out a way to consumers want grace—a task more difficult because its exper- sn't with credit cards. Indeed, x has a history of maligning some cards as debt traps. And the orig- Optima, a credit card marketed to x members, has been treated inter- as a poor relation—partly because

Leaving Home Without It



Optima racked up \$155 million in losses in 1991 from poor credit decisions.

Now, AmEx is singing a different tune. No longer are Visa and MasterCard down-market pretenders. In fact, Golub says he doesn't dismiss the idea of issuing his own Visa or MasterCard—an option once anathema to AmEx veterans. That would address another problem: Just 3.7 million merchants accept AmEx cards, a third of the number that take Visa. "They still suffer from their Achilles' heel—low acceptance," says David Brancoli, a spokesman for Visa. Golub believes Visa's numbers are exag-

True Grace faces one big marketing obstacle: A generous grace period is less tangible than, say, GM/Mastercard's discount on a new car

gerated. An AmEx ad campaign launched Oct. 13 challenges Visa's claim.

As it is, though, True Grace almost certainly will lose money for several years—though Moszkowski expects that AmEx has already absorbed most expenses. As he attempts to boost Optima's receivables fourfold, to \$30 billion, by decade's end, Golub plans to offer a wide array of new niche cards—between 10 and 15 in the next few years, each targeting up to one million users. "It takes significant resources to launch a card. To launch 10 to 15 is a huge mandate," says Jqan Solotar, an analyst at Donaldson, Lufkin & Jenrette Securities Corp.

"ELEPHANT DUST." New offerings likely will cannibalize the company's existing card business, eating into the \$66 million in fees AmEx will earn this year. But Golub sees a bigger payoff. Rivals expect he will seek out big allies to offer "co-branded" products, the hottest segment of the credit-card business. Two names on the grapevine as possible partners: Walt Disney Co. and Delta Air Lines Inc. Another possibility: a "create your own card" that would let consumers add their own features—such as a frequent-flier program or buyer protection plan—by paying for each separately.

Facing the prospect of such an onslaught, it's no wonder Visa has gone on the attack, spending big on newspaper ads that lampoon Optima. "They're throwing up elephant dust so people get confused," declares Golub. A little elephant dust may do the job: Grace isn't easy to sell, and its success isn't assured. But if AmEx wants to recapture past glory, it needs a new generation of plastic to lead the way.

By Leah Nathans Spiro in New York

ARE IBM AND APPLE A DAY LATE?

They may have missed their chance to create a new standard based on the PowerPC

For the moment, at least—it looks like a done deal and a mean game of catch-up. Three years after forging an alliance around the ultrafast PowerPC chip, IBM and Apple Computer Inc. are close to an agreement to create a single hardware "platform" around the PowerPC. From that one design, computer makers around the world could create clones that run software for either IBM or Apple personal computers—forging a universal standard that just might do what IBM and Apple separately have failed to do: shake Intel Corp.'s mighty grip on the world's personal computer business. Just the rumors of a deal sent Apple and IBM shares climbing—from Oct. 6 through Oct. 12, IBM was up 5%, to 73%, while Apple jumped 10%, to 42%.

THE KINDNESS OF RIVALS. For the record, neither company is talking. "We're not going to comment on the talks until there is something to announce," says IBM Chairman Louis V. Gerstner Jr. But inside sources say the negotiations are far-ranging—from the two companies agreeing on a common computer design to IBM taking a 5%-to-10% stake in Apple in order to provide the funds for the tricky software and hardware development needed. Insiders say Apple's costs could be upwards of \$50 million, a huge sum on today's skimpy 26% gross margins. Rumors have swirled since last summer that IBM may buy Apple outright—though analysts think that unlikely.

The Apple talks aren't IBM's only attempts to restart its floundering PowerPC effort. Even as IBM executives shuttle back and forth to Apple's Cu-

pertino (Calif.) headquarters, Big Blue has been trying to rebuild bridges with Microsoft Corp. to get access to its mass-market software. IBM PC chief G. Richard Thoman has met with Microsoft Chairman William H. Gates III in recent months. And IBM has approached Microsoft for access to Windows 95, the forthcoming rewrite of Microsoft's popular operating software.

Microsoft says it might cooperate on a version of Windows 95 for the PowerPC. Microsoft Executive Vice-President Steven A. Ballmer says the company would consider licensing the computer code. Blue would need to run Windows 95 applications programs on OS/2.

How did IBM wind up depending on the kindness of rivals? Aside from Apple, which is using the PowerPC to repl-

IBM's Long March

OCT. 91 IBM PC chief, James A. Cannavino, ceases a partnership with Apple and Motorola. They agree to joint development of the PowerPC chip, based on an IBM RISC design.

OCT. 92 The first PowerPC chip is introduced. But few PC makers sign on; Apple takes most early shipments.

JULY 93 IBM creates the Power Personal Systems Div. to try to redefine the PC standard with desktop computers based on the PowerPC chip.

NOV. 93 IBM shows PowerPC prototypes, including a sleek black model that re-

sponds to voice commands, and handwriting, and features a simulated talking head to offer help.

NOV. 93 Lacking a personal computer operating system for PowerPC machines, IBM cuts a deal with Microsoft to use a version of Windows NT.

**MACHINES
BASED ON
NOBUO MIYASAKI'S
DARING
POWERPC
PROTOTYPES
ARE NOWHERE
IN SIGHT**

But IBM's effort could still prove futile. The reason: Big Blue is clearly tying its PowerPC strategy to OS/2 in the hopes of making that software an alternative to Microsoft's Windows. That not only complicates negotiations with Microsoft but it has also put IBM behind schedule—OS/2 software for PowerPCs may not be ready for nine months. And while Mi-



an aging line of Macs, the technology has failed to catch on with most computer makers. Bugged down by internal politics, IBM hasn't even marketed a PC that uses the technology, and it has won little support from software developers.

the situation is quite a comedown Big Blue. Last fall, it looked like company had a good plan to set its course: It intended to create a new standard based on PowerPC hardware and the technically impressive OS/2 operating system. IBM's newly created Power Personal Systems Division, led off sleek, black prototypes of desktop and laptop PowerPC machines with software to let them hear, speak, respond to hand motions. The business plan was just as daring. The machines would be aggressively priced despite internal opposition, they would run not only IBM's OS/2 but also Microsoft's Windows NT and other operating systems as well. Nobuo Mii, president of the division, told a reporter at the time: "It has been a real war internally."

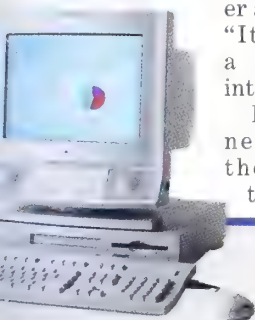
Mii lost the next battle, though. Anthony E.

would have been a setback to come out without a complete system," explains Phillip D. Hester, vice-president and head of IBM's Systems Technology & Architecture Div.

Still, if IBM hits its new shipment date of mid-1995, Richard Zwetchkenbaum, an analyst with International Data Corp., thinks it won't sell more than 100,000 personal computers based on the PowerPC in 1995. That's not even a blip in the 50 million-unit global market.

Even if IBM were to sell 10 times that number, it may have lost forever the chance at its bigger goal: to create a new industry standard. While Big Blue flubbed its own internal development and dickered with Apple,

propriate software for the PowerPC could be ready for market—even if IBM had the agreements in place today to guarantee either development. Indeed, IBM doesn't expect big volume from its PowerPC machines for two more years. But by 1996, Intel will be ready to launch P6, its post-Pentium chip. And



94 Canon licenses the technology to consumer goods, including notebook computers, and products.

94 Development partner Apple launches the PowerMac PC line, the only personal computer using the PowerPC chip.

elli, a former IBM PC executive, was brought in as co-ordinator manager to take over marketing and development activities. And the head-snapping designs Mii promised by the end of this year are nowhere sight.

FOUR DESIGNERS. In fact, Thoman announced in September that no personal computers based on the PowerPC will be introduced this year. The question? IBM has decided that such machines must have OS/2—as well as the many new features shown last year. But the project to rewrite the OS/2 operating system—which now runs only on Intel chips—has bogged down. "It

MAY 94 Robert J. Corrigan (below), head of the IBM Personal Computer Co. and high-profile backer of Intel and Microsoft, steps down.

JUNE 94 IBM brings in Antony E. Santelli as general manager of the PowerPC desktop division.



CORRIGAN: LUKEWARM ABOUT THE POWERPC

the PC market has moved on. Apple brought out Macintoshes based on the PowerPC chip in March. At the same time, the Intel/Microsoft camp got stronger—and is likely to get stronger still.

This year, PC buyers are flocking to powerful machines based on Intel's Pentium chips and are getting ready for a major software upgrade with Microsoft's Windows 95. "A whole year has gone by, and IBM has nothing to show for it," says a former IBM PowerPC systems architect who recently left in frustration.

It will be 1996 at the earliest before a common IBM-Apple platform and the ap-



SEPT. 94 IBM postpones launch of PowerPC desktop machine until the middle of next year, citing software delays and a lack of applications. Apple announces plan to license its PowerMac technology.

OCT. 94 IBM unveils a PowerPC workstation with PC features but no PC operating system.

POWERPC CHIP PRODUCTION: CAN IBM BREAK INTEL'S LOCK?

Microsoft will be moving toward Cairo, its next big software release.

All this, insiders say, has left IBM's PowerPC unit demoralized. Many designers are furious that IBM's PowerPC machines aren't on the market yet. "I'm sick to my stomach over what's

happened," says Rajat Datta, a systems engineer who plans to leave the company this month.

IBM executives insist, though, that the game isn't over yet. In addition to its possible deals with Apple and Microsoft, IBM is developing new chips, including a version of PowerPC that will imitate Intel chips. And in September, Japanese giant Toshiba Corp. agreed to build machines around PowerPC, joining some 30 other clonemakers. Progress to be sure. But as IBM's furious negotiations with Apple show, time is running short.

By Peter Burrows in Austin, Tex., with Kathy Rebello in San Francisco and Ira Sager and Amy Cortese in New York

One mistake: IBM decided its PowerPCs should use OS/2, but the project to rewrite that software has bogged down

THE ADMINISTRATION

'THE TEFLON VICE-PRESIDENT'

All the discontent that's stuck to Clinton has slid off Gore



ROLE REVERSAL: *The Veep is a more sought-after campaigner than the Prez*

As the countdown to Election Day '94 approaches, Bill Clinton and Al Gore are setting off on campaign swings that include stops from California to New York to Ohio. Nothing remarkable about a President and Vice-President stumping for party candidates, except for one surprising fact: Gore may be more welcome than his boss.

As Clinton's popularity drops precipitously, his No. 2 continues to shine (chart). "Vice-Presidents generally do worse than their Presidents, but Gore appears to be the Teflon Vice-President," says Paul C. Light, a University of Minnesota professor.

"SQUEAKY CLEAN." Gore's image as a wholesome stiff with a war record is a big plus to a public that questions Clinton's slickness. "Clinton personifies the problems we're having," notes a top Democratic adviser. "Gore escapes all of that—and he's squeaky clean." The Veep, moreover, has taken the lead on issues—such as reinventing government—that tap into voters' snarly anti-Washington mood, while Clinton has taken the heat for Whitewater and health-care reform. "The Vice-President picks and chooses his battles wisely," says Democratic consultant Brian Lunde.

Administration political aides believe

Gore can even help shift the balance to Democratic candidates fighting tight midterm election races. The White House has booked him for twice as many campaign stops as Clinton, with many visits targeted for the kind of socially conservative districts where his Boy Scout image plays well—despite his elite background. One example: Gore's efforts to reform the federal bureaucracy is likely to appeal to Arizona independents, so he is scheduled to campaign there for Representative Sam Coppersmith, who is battling for an open Senate seat.

Gore, of course, could suffer if he outshines the President too much. That might raise suspicions among Clinton loyalists that Gore may be overly interested in furthering his own ambitions. Aides to both men scoff at the possibility, saying the relationship is too close to break apart. "The President knows that the Vice-President is extremely loyal," says a senior White House aide.

If anything, Gore seems more trusted as an adviser than ever, particularly in foreign policy decisions. Decisions where Clinton is often not, senior advisers say he persuaded the President to take a hard line on Haiti. Gore also is the key contact with former President Jimmy Carter during the North Korean standoff this past summer. The Veep helped Clinton focus his Sept. 26 speech to the U. N. around a broad vision: how the U. S. can help developing nations establish free-market democracies. As early as 1991, he lobbied the Clinton administration to seek appointment of a special Watergate prosecutor, arguing that getting the answers out quickly would be politically wise.

BROADENING HIS BASE. Beyond his role as Presidential counselor, Gore is pursuing an agenda of his own. Next year, for example, he will head up a program to spur inner-city investments, preside over the distribution of funds from the recently passed crime bill, and step up his plans for streamlining the bureaucracy. These issues will allow him to strengthen his New Democrat credentials while keeping him open to the party's liberal base. He will also continue pushing environmental issues and developing an information infrastructure.

Gore is using these second-tier issues to broaden his base of support, particularly with business. During a February visit to Buenos Aires for a telecommunications speech, he persuaded Argentine President Carlos Menem to introduce a bill that would protect intellectual-property rights of U. S. drug companies. Now he's heading up a U. S.-South African commission to promote energy, technology, and other investments in the newly democratic country. A similar endeavor with Russia has

to expanded U. S. investments there. Gore could use a boost with business: A recent BUSINESS WEEK poll showed him with an abysmal 36% approval rating among to executives.

If he avoids pratfalls, Gore likely will emerge as his party's logical post-Clinton leader. Yet balancing acts like the one Gore is pulling off are perilous. Even popular Veeps can be dragged down—just ask Walter Mondale.

By Susan B. Garlan in Washington

GORE STILL RATES...

FAVORABLE UNFAVORABLE

AL GORE 56%

BILL CLINTON 47%

DATA: SEPT. 6-7 POLL OF 1,022 PEOPLE BY THE GALLUP ORGANIZATION FOR USA TODAY AND CNN

...BUT BUSINESS DOESN'T LIKE HIM

AL GORE 36%

DATA: SEPT. 19-26 BUSINESS WEEK/LOUIS HARRIS & ASSOCIATES POLL OF 400 EXECUTIVES

PEOPLE

LARRY KINGMAKER LIVE?

NN's star interviewer is a thriving enterprise

less than a month until Election Day, and Larry King is everywhere. Having helped launch Ross Perot's presidential campaign two years ago, the man with the Brooklyn growl, the present suspenders, and the symphonic style has emerged as a major campaign force again. From his Washington studio, he has already moderated California's Senate debate and is negotiating to do the same for Virginia's gubernatorial and Florida's gubernatorial. For relief, he jetted off to Hollywood to chat with actor Marlon Brando, who gave him a kiss on the lips. Then, he was off again to New York, back to California, and who knows where after that.

Applying his own brand of journalism to interviews with political hopefuls and authors on the make, King's furrowed brows are beamed into an estimated 1 million homes nightly. And he's fueling Larry King's business interests—a collection of talk shows, radio, newspaper columns, and speaking engagements—toward revenues of \$4 million a year.

SHUCKS QUALITY. King takes it all in with a shrug. "I honestly like it I do. I don't do it for the money," he says, preparing to interview a book-clubbing Lauren Bacall that evening. "I have a talent, like the baseball player who gets \$3 million a year after practicing for years to hit a ball." The talent? Hard to define, but it starts with King's deference, the way he gives guests to express themselves. "It's that aw-shucks quality," says political analyst Sherry Ben Jeffer of the Center for Politics & Policy at Claremont Graduate School in California. "He's not a really hard-hitting interviewer, but his show is a show for the media elite. Opinion makers watch the guy."

to do lots of other people. King is

scheduled to pull down \$45,000 for a half-hour talk in San Diego on Nov. 19—after placing first among media leaders in a poll of the 3,000-member San Diego Chamber of Commerce. Three years back, pre-Perot, he charged only \$15,000 a speech, agents say. Don Walker, one of his agents, says he currently averages two gigs a month at about \$50,000 each. Who is willing to pay that kind of freight? King lately has been booked by the likes of the Video Software Dealers Assn., the American Society of Travel Agents, and the American Hardware Manufacturers Assn.

For their money, conventioners get

"He's not a really hard-hitting interviewer, but his show is a show for the media elite. Opinion makers watch [him]"

vintage King dropping inside dope on interviewing Jackie Gleason in Miami or how Vice-President Al Gore pressed to have the NAFTA debate with Perot. Then, there are his childhood stories of growing up with future Hall of Fame baseball player Sandy Koufax. (Never mind that Koufax later told reporters he didn't know King until they were both adults or that King admitted to *Time* that the story was "part fact, part history, and part imagination.") "He's the funniest man alive on stage," says George F. Martin, the lawyer who has lined up King for a 30-minute speech at a daylong affair on Oct. 15 in Bakersfield, Calif. It'll be King's second appearance at Bakersfield, says Mar-

ALL EARS: For \$2.5 million a year, King goes into 1 million TVs a night

tin. The first time was in 1989, when King—now divorced for the sixth time—took time off from a honeymoon.

It's all heady stuff for King, who changed his name from the less euphonious Larry Zeiger to land a job as a sportscaster in Miami back in 1957. In 1978, he filed for bankruptcy. Now, he earns \$1 million a year in speaker's fees, on top of the \$2.5 million he gets annually to do his hourlong show each night. (Last year, with competition eating into his ratings, he cut back his radio talk show from three hours, and the show is now simulcast on the Mutual Broadcasting System.) Other King projects include a weekly *USA Today* column and his 1992 autobiography, *When You're From Brooklyn, Everything Else is Tokyo*.

MOVIE ROLE? That book is one of six King has written—mostly with ghostwriters. His seventh, *How to Talk to Anyone, Anytime, Anywhere*, is due out in November. None has been a big seller, he admits. King, who suffered a heart attack in 1987, gives the royalties to his foundation to aid the American Heart Assn.

Where will Larry King show up next? So far, says another of his agents, Gregg Clifton, CEO of Boston's Bob Woolf Associates Inc., he's not looking to do commercial endorsements. A television or movie role is one possibility, King says. For instance, he "starred" in an Oct. 9 episode of *The Simpsons*. Seems there's an election on, and Larry King is called in to moderate the race's debate in front of something called the League of Uninformed Voters. Even in Hollywood, it appears, no election can do without the man in the suspenders.

By Ronald Grover in Los Angeles

TRIALS

THE EMPTY CHAIR AT GE'S DIAMOND TRIAL

Its strongest testimony may come from an absent co-defendant

Did General Electric Co. conspire in 1991 and 1992 with rival De Beers Centenary to jack up industrial diamond prices? The Justice Dept. says yes. Beginning on Oct. 24, GE will try to prove otherwise in federal court in Columbus, Ohio. The outcome could turn on videotaped testimony of a key witness: Peter Frenz, the European sales chief for GE's diamond operation and a co-defendant.

Like GE, De Beers, and French executive Philippe Liotier, the other defendants in the case, Frenz, 60, claims to be innocent. But only GE must stand trial here: Extradition laws and other complications prevent the government from forcing Frenz, who is German, and the other non-U.S. defendants into court. Instead, U.S. District Judge George C. Smith allowed Frenz to testify on GE's behalf on videotape, which he did for six days in London.

FAX FIX. The danger: Jurors could assume that since Frenz refuses to appear in person, he—and by extension, GE—are guilty, a syndrome attorneys call "the empty-chair problem." Even Dan K. Webb, GE's lawyer, admitted at a hearing that that is "an enormous problem."

Why is Frenz key to the case? Prosecutors contend that the 25-year veteran of GE's diamond-making unit exchanged information with Liotier, who in 1991 was chief executive of a big GE customer in Belgium called Diamant Boart. At the time, Liotier was also a director of Diamant Boart's parent, Sibeka, which owns 50% of De Beers' diamond-making operations. The government claims the information the two exchanged allowed GE and De Beers to coordinate list-price increases in 1991-92. The Justice Dept. contends that top GE and De Beers officials had already met earlier and set the stage for price-fixing.

The government has dug up some seemingly damaging evidence against GE. For one, a December, 1991, fax from Frenz to the GE diamond unit's Ohio headquarters says in part: "...Liotier is supporting a price increase and would like to know by December 18, 1991, 18.00 hours European time, whether [GE] is going to follow." The recipient of the fax, Stephen T. Palovchik, a GE manager who was then Frenz's boss, says

that in following De Beers' later price hikes on other, less important kinds of diamonds, it was simply innocently doing what businesses do all the time. Frenz had no pricing authority, GE says, and his dealings with Liotier were ordinary contacts between it and a major customer.

Another twist in the case: It was Justice, but an ex-chief of GE's diamond business, Edward J. Russell, who first claimed that the diamond unit had tried to fix prices. Fired by GE in November 1991, he sued, claiming he was axed because he was a whistle-blower. In February, he settled the suit, acknowledging in an affidavit that GE had fired him for that reason. And he went on to say he "never had any personal knowledge of any antitrust wrongdoing" by the company.

To GE and most others, that was a recantation. But Justice thought otherwise. "You have no personal knowledge [of wrongdoing] if all you know is what the crooks told you," says Justice lawyer Max Gillin, referring to Frenz's statements to Russell, who will testify at the trial.

NEW ATTACK. GE, of course, will attack Russell's credibility, which was tarred by the settlement. The Justice Dept.'s answer: It has subpoenaed the terms of the settlement, which besides already disclosed insurance benefits to Russell included a payment to his lawyer. If you buy a piece of evidence you should be required to disclose the price," Justice says in a court filing. GE strongly denies that it bought evidence and says Russell initiated settlement discussions. It has moved to quash the subpoena, which would breach a confidentiality agreement it has with Russell and his lawyer.

Both sides badly need a win. Anne Bingaman, the Clinton Justice Dept. antitrust czar, hopes to show that in crackdown on alleged corporate wrongdoing has teeth. And for GE Chairman John F. Welch Jr., the loss of a criminal antitrust case would be another major blow to his company's reputation on top of the Kidder Peabody fiasco. Given that, both sides figure it's worth a fight.

*By Zachary Schiller
in Columbus, Ohio*

THE U.S. VS. GENERAL ELECTRIC ET AL

THE PROSECUTION'S CASE



JUSTICE'S BINGAMAN

The Justice Dept. says GE and De Beers conspired to raise industrial-diamond prices, using an executive at a big GE customer with ties to De Beers as a go-between

GE'S DEFENSE



GE CHAIRMAN JACK WELCH

GE says there wasn't any agreement with De Beers and that it decided to raise prices on its own before it had information that De Beers was going to do so

in a sworn statement that "the appearance of the document bothered me since it could possibly be construed as an attempt to coordinate competitive pricing." Palovchik received immunity from prosecution for his statement.

But to General Electric, such comments are "speculative guesswork," and the fax is unimportant. "I'm going to prove to the jury that we made our own decision to raise prices in the late fall of 1991," declares Webb, which was "a good 30 days before we received any De Beers information." GE's position is

*Machine's
best
friend...*





TELEVISION

AT CBS, A STEADY FEED OF BAD NEWS

Low ratings, lost affiliates, undone deals—this isn't its year

When CBS Inc. recently offered to buy WVCY-TV in Milwaukee for \$10 million, the network knew it was not a princely sum. But it could hardly have expected this reply: "Research by your office will confirm that the offer is unreasonably low," wrote WVCY Executive Director Vic Eliason in a letter to CBS. "This television station was built and continues to operate with the donations of committed Christians throughout Southeastern Wisconsin. These people have sacrificed in order to have an alternative to the swill that passes as network television programming."

Swill? From the folks who bring you *60 Minutes* and the Winter Olympics? It has been that kind of year for the tarnished Tiffany Network.

SWIFT KICK. CBS lost its old Milwaukee affiliate to Rupert Murdoch's Fox Broadcasting Co. last May in a deal that spirited away eight of its affiliates. Now, as it scrambles to find replacements, the network has been stunned by a dramatic decline in its prime-time ratings. After three years on top, CBS has fallen to No. 3 in the three-week-old season (chart). "It's too early to yell, 'Disaster, man the lifeboats!'" says Betsy Frank, director of strategic media resources at ad agency Saatchi & Saatchi Worldwide. "But I'm sure it's enough to give the network pause."

Or worse. Executives close to CBS say the accretion of bad news—from ratings to affiliate defections to the loss of football to the failure of a merger with Barry Diller's QVC Inc.—has left employees badly demoralized. CBS Chairman Laurence A. Tisch can still draw comfort from a buoyant advertising market. But insiders expect him to bring in new managers or sell the network. Until he does, they're operating in limbo—at a time when CBS faces huge challenges. The company reported sharply lower earnings on Oct. 12: Net income for the nine months ended Sept. 30 dropped 15%, to \$237 million, on revenues of \$2.8 billion.

Ratings, of course, are ephemeral. CBS has been dragged down in large part by woefully unpopular TV movies, such as *The Gambler* V with Kenny Rogers. And CBS Research Chief David F. Poltrack notes that the network's new series, led by police drama *Due South*, have done 20% better in their time periods than last year's shows. "Two weeks do not a season make," says Howard Stringer, president of CBS Broadcast Group. "We're a very

TICK, TICK, TICK: *60 Minutes'* ratings have fallen by 11%

good second-half team." Indeed, the network edged out ABC and NBC in the season's third week, thanks to the *Country Music Awards*.

Some of CBS' ratings problems offer easy solutions, though. Without pro football games as a lead-in, *60 Minutes* has dropped 11% in the ratings, to a record 16.2 (each rating point represents 940,000 TV households). In Cleveland and Phoenix, where the affiliate shutdown has forced the network to lower-powered stations, the *CBS Evening News* with *Dan Rather & Connie Chung* has lost 50% of its audience. It could be even more when VHF stations in Atlanta and Detroit bolt from CBS.

DEFLECTIONS. The bigger problem for CBS is its scramble to replace affiliates, which so far has seen mixed results. The network will wind up with weaker stations in five of the eight markets affected by the Fox deal. In Atlanta and Detroit, CBS is moving into nosebleed territory on the dial: Channels 69 and 12, respectively. In Boston and Baltimore, however, CBS won a key victory by snatching powerful VHF stations in a deal with Westinghouse Broadcasting Co. Stringer contends the network has bounced back quite well from Fox's run. "We started off at Little Bighorn and got out of there."

For Tisch, the affiliate wars matter far more than CBS' current ratings. With Disney Co., Time Warner Inc., and other prospective buyers want networks for their distribution systems, not their

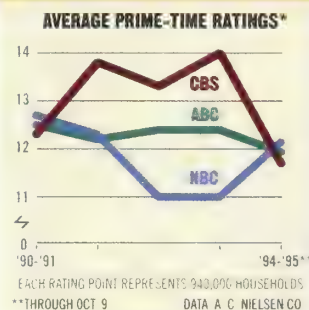
programming. Maybe that's why the ratings slide hasn't deterred Disney Chairman Michael D. Eisner or QVC's Barry Diller from revisiting deals with Tisch. Hollywood executives on both men have recently mulled a plan to buy CBS with Disney acting as financier and Diller as chief executive.

The catch is, Tisch still wants a rich premium on CBS. He's not likely to sell

one until his network patches up its affiliate system. So Stringer must boost the morale of his troops while sending weary lieutenants on more treks to places like Milwaukee. It may not be Little Bighorn at CBS, but it's looking like a long and arduous campaign.

By Mark Landler in New York, with Ronald Grover in Los Angeles

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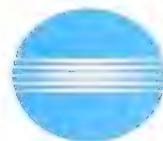
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MINOLTA

PEOPLE

'I AM TREATED ...LIKE A VIRUS'

Will General Services' Roger Johnson be forced out?

Few chief executives would have been less likely to back Bill Clinton's 1992 bid for the White House than California electronics executive Roger W. Johnson. But the longtime Republican crossed party lines after concluding that Clinton would be a strong advocate for high tech. As a reward, he was brought in to overhaul the troubled General Services Administration, the government's landlord and procurement agency.

Now, a year after taking the GSA's helm, Johnson has become the latest Clintonite under investigation. In late September, the agency's inspector general launched a probe of whether he improperly used agency employees for a range of personal chores, such as having his car washed and waiting for a furniture delivery to his home. On the advice of his lawyer, Johnson declined to discuss the probe with *BUSINESS WEEK*. But an Oct. 5 GSA statement says he admits that some "inadvertent actions" occurred, including getting voluntary help from staffers. When he realized the help was inappropriate, Johnson "took steps to make sure [it] did not recur," the statement said.

"PACK OF WOLVES." If the charges are true, these minor indiscretions could prove politically fatal to the 60-year-old former Western Digital Corp. CEO. After the ethics imbroglios involving two Cabinet members, Mike Espy and Henry G. Cisneros, and an earlier flap in which Johnson voluntarily reimbursed the government for more than \$1,000 in plane fares, overnight mail, and long-distance phone calls, the White House may move to avert further scandal. The GSA chief will "leave quietly" and soon, predicts a White House official.

Ironically, some observers think Johnson has done well at the GSA from a business standpoint. He generated \$827 million in savings over the next 30 years by delaying or scaling back 192 construction projects—mostly new federal courthouses. He has begun to

loosen the GSA's monopoly on purchasing and leasing. And he ordered the agency to compile its first profit-and-loss statement to spot trends in GSA functions.

But Johnson has proved a poor student of Politics 101. The changes he wrought spawned attacks from real estate developers, lawmakers seeking to protect pork-barrel projects, and the GSA bureaucracy. "There's a group inside the GSA that didn't want him, and they've moved unrelentingly on him like a pack of wolves," says Representative James A. Traficant (D-Ohio), an early critic who has since rallied to Johnson's defense. Even Johnson admitted in a September interview that "I am treated, in many cases, like a virus."

But Johnson compounded his problems early on with a headstrong approach that alienated Capitol Hill, notably Representative Jack Brooks (D-Tex.), the author of many procurement laws. Many lawmakers also chided Johnson for not soliciting their advice on proposals. Since then, Johnson's efforts to mend fences, including regular breakfast meetings with lawmakers, have helped repair his image with critics such as Traficant.

Failure to make peace with his own bureaucracy may be Johnson's undoing. Some employees fear his effort to establish "benchmarking" standards for comparing the GSA's performance with companies and other agencies is a precursor to further downsizing. Griper Bruce G. Williams, president of the GSA union local in Auburn, Wash.: "He's try-



SHAKEUP: Johnson generated \$827 million in savings and has loosened the GSA's monopoly on purchasing

ing to run the agency the way you would in the corporate world, and it doesn't work that way."

Williams claims credit for blowing the whistle on Johnson's plane trips to California. Some GSA employees have even developed an underground fax newsletter to spread dirt on Johnson.

Johnson's defenders are trying to counter the negative publicity. The GSA's chief financial officer, Dennis J. Fischer, contends that Johnson's ethics violations "are really nickel and dime compared to the savings from the [construction] review."

Fischer fears that Johnson's departure would send a signal to business peers to avoid government service. But the real message may be simpler: When it comes to government, reformers proceed at their peril.

*By Dean Foust and Amy Barrett
Washington*

Johnson's clashes with the GSA bureaucracy could be his undoing: Employees are spreading dirt on him by fax



OPLE

MEET WASHINGTON'S NEWEST WATCHDOG

ary Schapiro plans to put teeth in commodity futures rules

For months, the futures industry has decried the leadership vacuum at the Commodity Futures Trading Commission. Left without a chair-
man for nearly two years while the Clinton Administration dithered, the agency allowed critical proposals to languish and failed to target questionable practices that sullied the industry's reputation.

These days, traders are decidedly bullish on the CFTC. The reason: President Clinton's choice of Mary L. Schapiro to head the agency. A hard-
nosed securities regulator, Schapiro brings intimate knowledge of the futures markets from her stints as a CFTC enforcement attorney and as general counsel to the Futures Industry Assn. She wasn't appointed for her politics, she was appointed for her professionalism," says Patrick Arbor, Chairman of the Chicago Board of Trade.

PROTECTING INVESTORS. But the commodities pits may get far more than bargained for once Schapiro, who is scheduled to be sworn in Oct. 13, takes her agenda. Although she is widely expected to be an aggressive enforcer, her other plans suggest she will be far less sympathetic to the industry than it is anticipating now. "After about a year, they may wonder if [my appointment] is such a great idea after all," Schapiro says with a shrug. For starters, Schapiro will advocate

expanding her agency's reach—and getting the industry to foot the bill. The CFTC's staff has dwindled 12%, to 522, in the past three years, even as trading has skyrocketed 28%. Schapiro already has met with 30 lawmakers since June to lobby for an increase in the agency's \$50 million budget and may seek new industry fees to finance it.

Schapiro also is skeptical of the industry's plea for an extension—from 1995 to 1999—of a rule that would require traders to upgrade audit trails on trading activity. Exchanges had hoped she would buy their argument that the handheld computers needed for electronic auditing aren't ready. And Schapiro is considering repeal of antifraud regulatory exemptions for some hybrid commodity products, from which she feels investors need more protection.

Indeed, her pro-enforcement bent will dominate her agenda. That's a change the industry is applauding. "If there's

MOVIN' OUT: Schapiro packs up at the SEC, where she was a commissioner

wrongdoing anywhere, she won't put up with it," says John Benjamin, managing director of Smith Barney Shearson Inc. In fact, during Schapiro's six-year stint as a member of the Securities & Exchange Commission, she stumped for harsh penalties for supervisors who tolerated shoddy sales practices. She already has hired an SEC enforcer, John S. Polise, to overhaul the CFTC's policing program.

Schapiro is a savvy, 39-year-old New Yorker with a sure political instinct and friends in both political parties. A registered Independent, she was appointed to the SEC in 1988 by Ronald Reagan. Her CFTC appointment was championed by SEC Chairman Arthur Levitt Jr. and Robert E. Rubin, head of the White House National Economic Council.

POACHING. Levitt's endorsement could lead to warmer ties between the CFTC and the SEC, whose relations often have been strained. "She's independent, thoughtful, and tough," he says. Competitive, too. SEC insiders say the only time they've seen Levitt angry was when Schapiro poached key SEC staffers. She tapped Elisse B. Walter, the SEC's deputy director of the Corporation Finance Div., to be CFTC general counsel.

Levitt and Schapiro have since patched up their differences. In fact, the agencies already are working to-

gether to formulate a policy on financial derivatives. Traders argue that new rules aren't needed, since most customers are sophisticated institutions.

Schapiro isn't so sure. She worries about revelations that municipalities have been burned by derivatives investments and frets that pensions and mutual funds may be at even greater risk. If the industry and regulators don't act to stem abuse, she says, she will push for legislation. That's surprisingly tough talk from a CFTC chairman—and another indication that with Schapiro in charge, industry bigwigs soon may be longing for the days of the empty CFTC chair.

By Mike Schroeder in Washington, with Greg Burns in Chicago

Mary L. Schapiro

AGE

39; born in New York City

EDUCATION

Franklin and Marshall College; J.D., George Washington Univ.

EXPERIENCE

Started in 1980 as CFTC trial attorney and assistant to chairman. General counsel for the Futures Industry Assn., then a commissioner at the SEC. Met with White House officials about the CFTC chairmanship in January, two days before her first child was due; approved for the job Oct. 4.

HOBBIES

Daughter of an antiques dealer, she collects 18th and 19th century American pieces.

WHAT THE INDUSTRY CAN EXPECT

"A real dedication to enforcement, unlike any other chairman the agency has had."

COMMENTARY

By Michael J. Mandel

HOW GAME THEORY REWROTE ALL THE RULES

I have a dream," Martin Luther King Jr. proclaimed. Hardly an economic breakthrough. But King recognized that the first step in social change is getting people to believe that things can be different. When the status quo—such as racial discrimination, a dictatorship, or a depression—is seen as inevitable, it becomes much harder to fight. Similarly, the knowledge that South Korea and Taiwan have successfully modernized their economic institutions makes it much easier for China, Russia, and India to take the plunge.

Conventional economics, focused mainly on buying and selling in the marketplace, virtually ignores the possibility of social or economic change. But game theory—just honored by the 1994 Nobel Prize for economics—goes far beyond markets and into the realm of power, bargaining, cooperation, and trust. What game theory does is analyze the interactions between economic "actors" such as individuals, corporations, and governments, accounting for their entire range of possible options. Rather than simply accepting the status quo, the ultimate goal of game theory is to understand why existing economic and social arrangements are stable, and what the alternatives might be.

MULTIPLE OUTCOMES. Indeed, the three Nobel winners—John Nash of Princeton University, John Harsanyi of the University of California at Berkeley, and Reinhard Selten of the University of Bonn in Germany—made their major contribution by coming up with general principles for deciding when the outcome of an economic game or interaction is stable—in technical language, in "equilibrium." More and more, their techniques are being used to explain everything from the behavior of

central banks to the outcome of auctions to the research-and-development spending patterns of corporations. They have become a standard tool in almost all areas of economic theory, as the Royal Swedish Academy of Sciences noted in granting the award.

Yet the Nobel citation misses perhaps the central lesson of game theory. Applying the work of Nash, Harsanyi, and Selten, almost every economic and social game turns out not to have just one stable outcome, but many. Competition between rival

Harsanyi and Selten, who have devoted the second half of their career to unsuccessfully trying to eliminate multiple equilibria.

The pervasiveness of multiple stable outcomes has broader implications for policy. Often, economists talk as if there is only one correct way to solve an economic problem such as inflation or rising health-care costs.

BAD BALANCE. What game theory teaches us is that the range of possibilities is enormous, and it may be possible to shift from one arrange-

ment of economic activities—however stable—to a better one. "Sometimes the problem with our economy is that there are multiple equilibria and we're fixed on a bad one," says Larry Samuelson, an economist at the University of Wisconsin. "What we need to do is find a way to move to a good one."

Certainly, that's what the ex-Communist countries are trying to do now, as they grope their way toward a market economy. Closer to home, the use of monetary and fiscal policy to fight recession can be seen as getting the economy out of a bad equilibrium, where workers are unemployed and factories are idle, back to a better one. And although most economists see the U.S. as stuck in a slow-growth track, it may be that we are in the process of shifting to a fast-growth, high-investment form of equilibrium where capacity grows fast enough to head off inflation.

The idea that there are alternatives to existing economic institutions can be threatening to many people. But it also can be profoundly inspiring. That, in many ways, is the best news that game theory can bring.

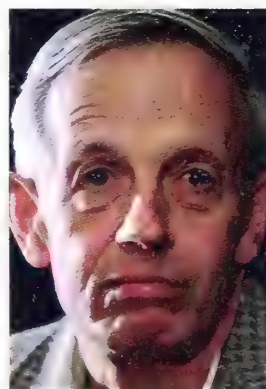
Economics Editor Mandel wrote his PhD dissertation on game theory.



BONN'S SELTEN



BERKELEY'S HARSANYI



PRINCETON'S NASH

airlines can degenerate into cut-throat price-cutting—or become a cozy duopoly. Developing countries can limp along for years in a no-growth equilibrium, or leap ahead into sustained economic expansion. Some cities have low crime rates with a small police force; others find themselves fighting a rising tide of violence.

This phenomenon of many stable outcomes—or "multiple equilibria"—has proven disturbing and embarrassing to economists hoping to use game theory to make predictions. Certainly, it has been worrisome to

Why are some
economic and social
arrangements stable,
while some aren't?

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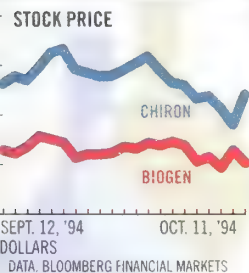
RE HEALING NATIONAL MEDICAL

NATIONAL MEDICAL ENTERPRISES (NME) will have to settle for a distant second. Its bid to merge with American Medical Holdings and HealthTrust, two rival hospital companies, was scotched when Columbia/HCA Healthcare purchased HealthTrust away from NME in a \$3.6 billion acquisition. On Oct. 11, NME announced it would buy AMH anyway, for \$1 billion—but the smaller combination will leave NME with a third of Columbia/HCA's stock. Still, the deal marks the end of a dramatic turnaround. In the past year, NME executive Jeffrey Barlow has paid \$380 million to settle fraud charges from the Justice Dept., and he has

CLOSING BELL

BIO-BUBBLE

The anxiety for frazzled biotech investors. Biogen's new interferon- α -1a drug in trials appeared to delay dramatically the progression and reduce attacks of multiple sclerosis. Wall Street pushed Biogen shares up \$5.50 on Oct. 7, to \$54.75, and shaved \$1.38 off on Oct. 11. Chiron, which sells a related drug called Betaseron. An odd reaction: Even if Biogen's product is approved, it won't be on the market for two years at best. In the meantime, says consultant Cynthia Robbins-Roth, Biogen's study forces the value of Betaseron. On Oct. 12, investors seemed to agree. Chiron recovered \$4 to \$50; Biogen sunk back to \$50.



gotten rid of NME's scandal-ridden psychiatric hospitals. Profits, and NME's stock, have rebounded smartly.

BIG STEEL AND THE MINIMILLS TEAM UP

IT HAS BECOME THE CIVIL WAR of America's steel industry: Big Steel against the minimills. Now, the standard bearers of that fray are going into business together. In a joint venture, USX's U.S. Steel group and Nucor will try to develop technology to turn iron carbide directly into steel. Such technology could eliminate costly—and dirty—steps from the steelmaking process. This is important for Big Steel, which faces steady environmental pressure to clean up or eliminate coke ovens. Nucor, which makes its steel by melting scrap, says it also will build new steel mills for the iron carbide process if the technology works. "We can't stand still," says Nucor Vice-Chairman Samuel Siegel.

U-HAUL: A TRUCKFUL OF DOLLARS

GREED. BETRAYAL. MURDER allegations. The six-year family feud at U-Haul has made Herbert Haft's much-publicized squabble at Dart Group look like a love fest. But on Oct. 7, ousted U-Haul founder and family patriarch L. S. Shoen, together with 6 of his 12 grown children, won a mammoth \$1.47 billion jury award for their 47% stake in the truck-rental company that they claim was squandered by a competing family faction—which itself says the stake is worth far less than that. The jury also ordered son Joe, who named himself chairman of U-Haul in 1987, to fork over \$70 million to his father in punitive damages for his "hateful and malicious dealings."

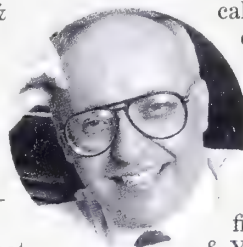
HEADLINER

ERNST & YOUNG SCRAPS A SCRAPPER

For 22 years, Carl Liggio played troublemaker in an industry accustomed to order and discipline. As general counsel for accounting giant Ernst & Young, he was loath to settle a case. "He would never surrender," says the firm's outside counsel, M. Laurence Popofsky.

Until Oct. 1, that is, when Ernst & Young chief Philip Laskawy replaced Liggio, 51, with Kathryn Oberly, a 44-year-old lawyer known more as a shrewd facilitator than an abrasive street fighter. Nine days later, his in-house army was shattered: 244 legal staffers, including

37 of 65 lawyers, were summarily fired. Liggio could not be reached for comment.



Industry experts called the move inevitable. While many lawyers praise Liggio's work, critics wonder whether his combativeness hurt the firm. When Ernst & Young paid regulators \$41 million in 1992 to end its troubles related to Charles H. Keating III's thrift, for example, it could have settled all the government's claims at once—as did rivals. Instead, it paid a record-breaking \$400 million to settle other cases.

By Linda Himmelstein

KATZENBERG STARTS A STARRY STUDIO

WEEKS AFTER LEAVING WALT Disney, former studio chief Jeffrey Katzenberg has found two partners—superstar director Steven Spielberg and billionaire record mogul David Geffen—to help launch his own studio. The company has no name and barely a business plan, but it does boast the combined billions of its three principals. Katzenberg promises a "Tiffany operation, [not] so big that we lose touch with the product," which will include films, TV shows, records, animation, and games. No TV network, Katzenberg says—yet.

WHAT WORKING WOMEN REALLY WANT

WHAT WORRIES WORKING women most? The Labor Dept. asked that of more than

250,000 women over four months, and the responses were remarkably consistent. More than 60% were concerned about low wages, job stress, and health and pension benefits. About 60% griped that they have little or no ability for career advancement. Affordable child care was cited by 56% of respondents with children under age five. Almost half said they are underpaid for their work. The study is to be released on Oct. 14.

ET CETERA...

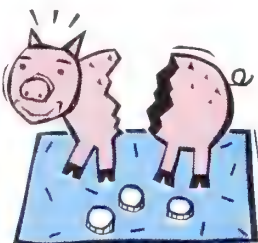
- TWA says it will file for bankruptcy again unless a new debt plan is approved.
- In the midst of a poor year, Goldman Sachs named a record 58 new partners.
- Ford Vice-Chairman Allan Gilmour resigned; the auto maker won't replace him.
- Pro hockey's owners rejected the players' last offer, placing the season in jeopardy.

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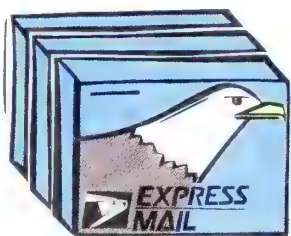
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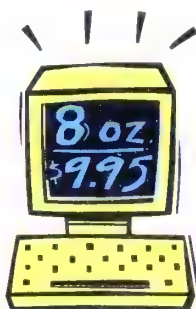
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UNITED STATES
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EDITED BY OWEN ULLMANN

CLINTON'S BUDGET DILEMMA: DO THE RIGHT THING OR THE POLITICAL THING?

Bill Clinton kicked off his Presidency with a massive and controversial plan to cut the deficit. It wasn't enough. Now, he's gearing up to fight Round 2 of the great budget battle.

At first glance, the President should have no trouble drafting a plan for fiscal 1996. The economy is strong, and the budget deal set tight ceilings for much government spending. So the deficit is falling rapidly—from \$254 billion in 1993 to about \$200 billion in '94 and an expected \$160 billion in 1995, which began Oct. 1. As a share of the gross domestic product, the red ink is the lowest in 16 years. Yet beneath the budgetary surface, dangerous crosscurrents threaten to pull Clinton into deep political water.

The danger for the White House is a coming collision between political and fiscal imperatives. Clinton wants the deficit to keep falling through his reelection campaign, but without another round of tough spending cuts, the deficit will start rising in 1996 and hit \$240 billion in 2000. Policymakers already are battling over how to do it.

MIDDLE-CLASS MESSAGE. Some top White House deficit hawks, including Office of Management & Budget Director Alice M. Rivlin and Chief of Staff Leon E. Panetta, want Clinton to attack the deficit by trimming entitlement programs, such as Medicare. Other advisers favor modest, politically safe nicks in domestic programs, say, \$20 billion a year.

Clinton's political advisers, on the other hand, are urging him to damn the deficit—and find money for a middle-class tax cut. The President has his own pet goals, too, that would add to the red ink. He'd like to "invest" up to \$10 billion in new programs, such as job training, and finance a welfare-reform overhaul that could cost an additional \$10 billion a year. Certainly, the President can't look to Congress for help.

Democrats are hopelessly split between liberal spenders, such as House Appropriations Committee Chairman David R. Obey of Wisconsin, and fiscal hawks, led by Representative Charles W. Stenholm of Texas. And the Republicans, who will likely gain a working majority in both the House and Senate next year, are staking out their ground in the coming budget debate. First out of the box: a balanced-budget amendment, which is likely to pass in 1995. Next up is a tax cut. The GOP is looking at some \$125 billion in personal and business cuts over five years but isn't saying how to pay for it.

With congressional elections just a few weeks away, no one is talking openly about cutting popular entitlements. House Republicans have taken a pledge to keep hands off of Social Security. But the unsettling problem will be spotlighted in December by the President's Bipartisan Commission on Entitlements & Tax Reform, a panel he was forced to establish as part of the '93 budget deal. The commission plans to issue a scary report on how exploding entitlement costs will swell the deficit, putting further pressure on the White House to curb programs such as Medicare and Medicaid.

In the end, the budget debate will probably turn on Medicare and other medical spending. Panetta, for instance, has signaled that next year's version of health-care reform should be repackaged as a cost-cutting effort rather than an overhaul of the health-delivery system. Yet Clinton is damaging Panetta's plans with attacks on the GOP for relying on cuts in Medicare to finance their promised tax breaks.

If he goes too far down that political road, the President may find he has cut off his options for trimming the budget. Instead, he'll be forced to run for reelection with the deficit climbing. And he'll get no credit for tackling the problem in '93.

By Howard Gleckman



RIVLIN: Eyeing entitlements

CAPITAL WRAPUP

REGULATORS

It's a good thing the Senate confirmed White House aide Christine A. Varney's appointment to the Federal Trade Commission before adjourning Oct. 8. The FTC had been operating with just three of five members. When Commissioner Roscoe B. Starek III is ousted from a review of Eli Lilly & Co.'s purchase of McKesson Corp.'s unit because of his holdings, only two members could hear the case this month. Varney breaks a potential stalemate.

THE PENTAGON

► Who says Pentagon war planners can't be ecologically correct? Bowing to the global ban on chlorofluorocarbons, the U.S. Air Force is removing CFCs from its long-range missile systems with multiple warheads. Now, if the weapons are fired, "it will be an environmentally friendly nuclear holocaust, not threatening the ozone layer," says the *Annals of Improbable Research*, a lighthearted journal published by Massachusetts Institute of Technology.

POLITICS

► Black voter turnout could be key to Democratic hopes of keeping a working majority in the House. The Joint Center for Political & Economic Studies, a think tank that deals with minority issues, found that of 28 districts with both close House races and large populations of black voters, 18 are held by Democrats. Analyst David Bositis predicts that many blacks will stay home because they're unhappy with Clinton and see few campaign issues that affect their interests.

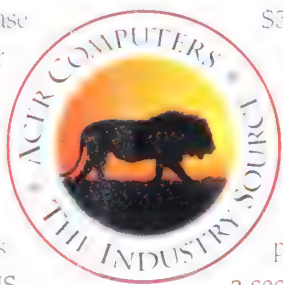
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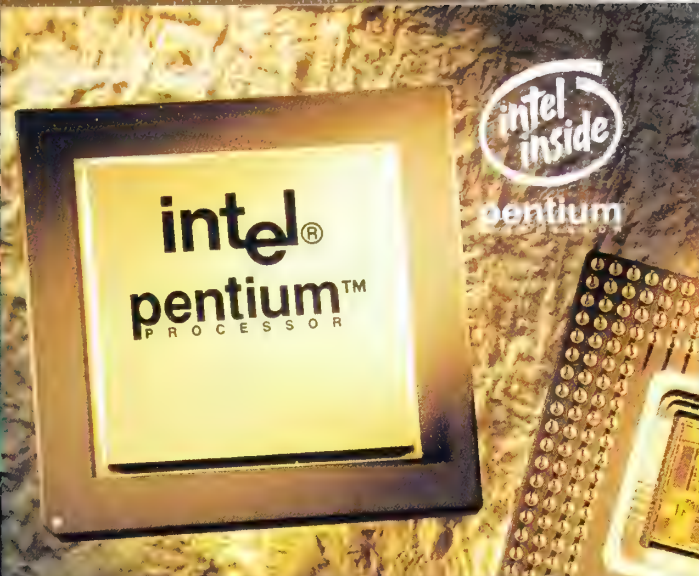


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MARKETS

TWO TIGERS SHARPEN UP THEIR MARKETS

The two most muscular Asian Tigers, South Korea and Taiwan, look primitive when it comes to their financial markets. Korea's are among the most heavily restricted in the world, while Taiwan's is rife with corruption. Now, with the appointment of a new economy czar in Korea and a crackdown on crooked dealing in Taiwan, these two enticing markets are taking important steps toward modernizing themselves.

KOREA A Wider Door For Foreign Cash

For many non-Koreans, watching the performance of Korea's stock market over the past six months has been excruciating. While the Korea Composite Index soared from 875 in April to a record 1,090 on Oct. 12, officials in Seoul kept promising to raise the ceiling on foreign stock ownership—only to delay the move. Stuck with limits allowing a foreign individual no more than 3%, and total foreign owners no more than 10%, in a single stock, investors sat on their hands in frustration.

Now, Korea is finally taking steps to open its financial markets, among the world's most tightly restricted. The promises of new Deputy Prime Minister Hong Jae-Hyung, who holds the government's top economic policy post, have a ring of conviction missing in the past.

One reason is that Korea wants to achieve the status of a fully industrialized nation by joining the Organization of Economic Cooperation & Development (OECD) in 1996. To do that, it must gradually remove restrictions on capital flows and satisfy the OECD that its markets will be completely open by 1998. Besides raising the limit on foreign shareholdings—to 12% beginning on Dec. 1 and to at least 15% next year—Hong permitted Pohang Iron & Steel Co. and Korea Electric Power Co. to list



TRADING FLOOR: The Korea Stock Exchange is slowly adopting new rules

American Depositary Receipts on the New York Stock Exchange in November. Next, the government will allow Korean individuals and corporations to invest in foreign real estate, maintain bank accounts in other countries, and buy foreign stocks and mutual funds.

"JUST A TEASE." If the Koreans follow through on their promises, Seoul could become a case study in how the volatile and overregulated markets of East Asia can evolve into more efficient ones. Hong's predecessor and other government officials, including the central bank governor, had strongly opposed opening stock ownership further to foreigners, charging that huge inflows of new funds would raise inflationary pressures. However, Hong appears to agree with international observers that an open market is a healthy market. And with locals free to raise funds abroad, the outflow of Korean capital to other

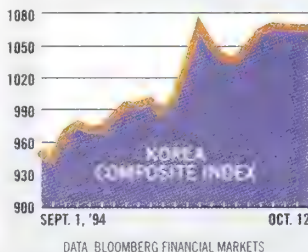
countries will probably more than offset any pressure from new foreign stock investments. The ability to borrow abroad should lower interest rates, too.

Outside Korea, some investors remain impatient with the pace of financial liberalization. The latest ceiling change to 12%, was delayed for nearly a year. The next three-point increment was supposed to have been in place by year-end 1994. "It's just a tease," says K. Tan Bhala, manager of Merrill Lynch

& Co.'s \$1.28 billion Dragon Fund in New York. Indeed, since foreigners were first permitted to buy Korean stocks in January, 1993, their holdings as of August had grown to less than 4% of total market capitalization.

Even with high ceilings, investing directly in Korean stock isn't easy. Foreigners

KOREA'S MARKET SHOOTS UP



open accounts in the country and legal, custodial, and proxy fees. of information and company re- n is a problem even for institu- investors, says John Lee, man- of Scudder Investor Services Inc.'s million Korea Fund. Japanese in- ers face the additional hurdle of a w dispute that has been raging ars.

thermore, there's a question about er non-Koreans will participate s like those the market has seen ear. That's because the promise of ore liberal foreign-stock limit has powerful fuel for the market. An- ing additional demand, local buy- ve bid up prices, intending to sell new crop of eager foreigners.

n Ok-Sun, for example, lost half a n dollars investing in Korean s between 1989 and 1993. But in ast three months, the 45-year-old wife recovered nearly 50% of what st. And if the market continues on ll run, as many local analysts ex- t will, she is likely to recoup all sses before yearend. Her stock- g method? "I chose only those t that are popular among foreign ors," says Kim, such as Samsung onics Co. The company's shares risen from \$54 in October, 1993, to today.

ING DEMAND. Such dynamics make in other countries wonder wheth- e market won't simply drift after w foreign buyers show up on Dec. e be very stock-specific, not coun- specific, in allocating money to Ko- says Merrill Lynch's Tan. Many s are overvalued, she believes.

judge by the market's perfor- e, however, believers outnumber eptics. The biggest attraction for n investors has been Korea's eco- outlook. Thanks to a rise in both stic and export demand for elec- s, white goods, and autos, corpo- rofits were up 75% in the first half e expected to cool only slightly second. Inflation seems less men- today than a month ago.

reigners' interest in Korea was nstrated this year, when around ion in equity-linked bonds issued rean companies in the Eurobond et were all oversubscribed. Similar- valued foreign institutional inves- immediately snapped up shares in new onshore equity trust funds h by Korea's smaller mutual- companies in September. All that nd means Korean and foreign in- ers alike should benefit, as liberal- n makes it easier to participate in ountry's remarkable growth.

Laxmi Nakarmi in Seoul, with Warner in New York



TAIWAN TRADERS:
The influence of big players has been sharply cut

money-supply in- stability will ensue.

The government has had some suc- cess, though, in minimizing the in- fluence of big hands. Oung is es- timated to control 5% of the market, but that's down from the 20% he was said to control in 1991. Privatiza- tions and a flurry of

TAIWAN Is a Cleanup Finally Beginning?

Taiwanese tycoon Oung Ta-ming has led a charmed life. Last year, the head of the diversified Hualon group was convicted in a \$22 million stock-manipulation scheme. But as a member of Taiwan's legislature, he claimed immunity to avoid jail and later won the case on appeal.

Now he faces another test. In early October, authorities closed four Hualon securities firms and arrested five close aides, alleging payment defaults totaling some \$125 million and manipulation of several stocks. In response, the stock market panicked, as the Taiwan Weighted Index (Taiex) dropped 15% in six days (chart).

With crucial local elections weeks away, Taipei is eager to limit the damage. How it handles this case may determine the power of "big hands" like Oung as well as the stability of the stock market. That could mean faster deregulation of the financial system, including a higher cap on foreign investment and stiffer rules against speculators.

To curb market volatility, the Securities & Exchange Commission supports increasing the foreign institutional investor cap from its current \$200 million. Foreign investors and mutual funds now account for less than 15% of total market capitalization. "We have urged the Central Bank to raise the foreign investment quota," says SEC Secretary-General Su Ler-ming. The bank refuses, fearing that foreign-exchange and

new listings appear to have limited the power of the major players. The goal, says Christopher Cheng, senior analyst with H. G. Asia Taiwan, is to "enlarge the market so no one single force can influence it."

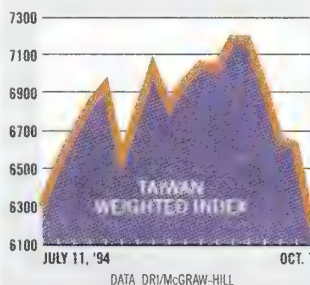
SEXIER SCANDALS. Reining in the speculators is difficult for the SEC. Probes of stock manipulation are handled by the Investigation Bureau, Taiwan's FBI, not the SEC. Since securities cases are easily upstaged by sexier political scandals, stocks fall to the bottom of the bureau's priority list. Moreover, SEC attempts to push through changes in the law have been blocked by legislators. That's not surprising, considering that many politicians, such as Oung, are the biggest players in the stock market.

Citing strong corporate earnings and 6% economic growth, most brokers don't expect the market to bleed to death. "The worst is over," says William J. McGrath, managing director of S.G. Warburg Taiwan. Likewise, Hualon, which has interests in everything from life insurance to pig farming, will likely escape mostly unscathed. Executives are still pushing forward with plans for a \$250 million textile factory in Northern Ireland, although two investigations of Hualon have begun in Britain.

Maintaining confidence in the Taiwanese government may not be as easy. Some analysts wonder whether it is really willing to take on powerful speculators. "There'll be some wrist slapping but nothing more," predicts John Bai, vice-president for Korea and Taiwan at Baring Securities in New York. To keep pace with its Asian neighbors, Taipei will need to prove such skeptics wrong.

By Margaret Dawson in Taipei

THE TAIEX TUMBLES



FRANCE

RIVALS ARE HOWLING OVER FRENCH HANDOUTS

Lawsuits loom as competitors try to stop aid to state companies



FLYING SOLO? The state claims subsidies will spruce up outfits for privatization

Like a heavy drinker whose doctor has ordered him to quit, France says it fully intends to give up an unhealthy and expensive habit: pouring tax money into state companies that can't stand on their own. Its European Union partners want greater sobriety in aid-giving, while Paris itself is weary of handing out the subsidies. But first, the French are going on one last toot.

And what a toot. The French are enraging Europe's free marketers by passing out huge gifts to state-owned companies—with the stated purpose of sprucing them up for privatization (table). Although European Union trust-busters in Brussels say this largesse is perfectly legal, corporate rivals are screaming. In the biggest aid case—Air France—seven competitors plus the British government plan to fight Brussels' ruling in court.

Even some French business executives are starting to holler. Jacques Calvet, chairman of auto maker Peugeot, says it's unfair for state-owned rival Renault to get taxpayer handouts to compete against him. He figures Renault has received \$4.3 billion in state aid

since 1982. Private-sector French bankers grumble at a continuing bailout of troubled Crédit Lyonnais.

Once again, France is becoming the bogeyman as the EU struggles to build

freer competition. If the latest French bailouts stand—and most of them probably will—critics fear they'll encourage companies elsewhere in Europe to seek aid with dubious justification. Under EU policy, a company may receive only an unabashed subsidy for restructuring. Such a subsidy is considered different from a legitimate capital increase that a "reasonable" private investor would make. Thanks to that ambiguity in the rules, Belgium's Sabena World Airline and Iberia Airlines of Spain, which have already received such "last-chance" aid, are thought to be pondering ways to get more help from their governments.

France's new bailouts could cause a strong backlash against the practice leading to stiffer European competition rules. British computer maker ICL is upset with the EU's approval of an aid package for French rival Groupe Bull, that it will press to tighten EU competition policy, says George Hall, ICL's head of corporate affairs. Moreover, the outcry over French handouts could well derail France's campaign to get one of two new EU commissioners named competition czar in January.

"SHORT MEMORIES." Of course, France isn't Europe's only subsidizer. Patrick heads the pack at the moment because of its drive to privatize 22 big state companies, whose finances must be put in order first. Every EU country has made similar moves. The British, who are leading the fight against Air France's aid package, "have short memories," complains Pierre-Alain Jeanneney, France's head of European affairs. "British Airways got state aid, too," he claims, to prepare for its 1987 privatization. BA denies that. Others

note that no one uttered a peep about two modest Dutch government-aid packages approved by the EU on Sept. 27—one for Volvo-Mitsubishi car plant, the other a \$60 million research grant to airplane builder Fokker and other companies.

Moreover, despite the current binge, France's total bailout have shrunk. They peaked at \$6.5 billion in 1986 and fell to \$943 million in 1991. Now they're creeping back up and should top \$2 billion this year.

Critics say the enormous sums being given to individual companies put France in a different league from its neighbors. Size will be the chief legal argument to knock down Air France's \$3.8 billion package. Rivals point out that the su-

France's Bailout Binge

AIR FRANCE

The airline landed a \$3.8 billion aid package last July, but seven other European airlines and the British government are suing to undo it

BULL

The computer maker won Brussels' blessing on Oct. 12 for \$2.1 billion in aid to help prepare for privatization

CREDIT LYONNAIS

After receiving \$925 million in aid in July, France's biggest bank will probably get more cash in January and turn bad loans over to the state

RENAULT

To help the carmaker privatize, the state will probably put up half of a \$377 million capital increase



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equals some 60% of British Airways' market capitalization. "It is grossly in excess of what is necessary," says Trevor Soames, a lawyer representing British Midland Airways Ltd., which plans a lawsuit to block the handout.

GRUMBLES. In the past, it was tough for companies to challenge such rulings. Most that tried lost. But last year, a relatively new entity, the Court of First Instance, was given power to hear corporate complaints about commission decisions. A ruling by the court on Air France could set a key precedent about

the type and amount of legitimate aid.

France's other big aid recipient, Bull, may not need to go to court. Although competitors grumble, they seem inclined not to challenge this aid package directly. That's because it's accompanied by a restructuring that should allow privatization in a year or two, removing Bull permanently from the government trough. Rival bankers probably won't fight the expected new bailout of Crédit Lyonnais because the failure of Europe's biggest bank would be a catastrophe.

Air France's situation is different.

Keeping it aloft and in French hands is simply a question of national pride. Moreover, many airline experts complain that the carrier will use its cash to cut debt, not to go through the wrenching layoffs and route cutbacks essential to reduce costs. "In five to seven years, they're going to need more state money," predicts one U.S. airline official. Then, however, the EU will surely have declared the party over for Europe's generous aid givers.

By Stewart Toy with Gail Edmondson in Paris and Patrick Oster in Brussels

MEXICO

DECLARING WAR ON THE PIRATES

Mexico is cracking down—but record companies want more

Days before Warner Music planned to release Luis Miguel's *Aries* last year, pirated cassettes of the Mexican teen idol's album hit the streets. Music pirates had stolen a CD from the company's Mexico City warehouse to produce the copies.

So when Luis Miguel's most recent album came out at the end of August, Warner took no chances: It made the CDs in Canada and chartered a plane to fly them to Mexico just before release. Still, pirated cassettes were selling on the street for \$1.50 within hours.

Fed up, Warner and other international music companies are trying to shut down the Mexican pirates, whose wares now account for two out of every three cassettes sold in Mexico. That makes it the world's second-largest pirated-music market after China. To capture an estimated \$200 million a year in lost revenues, international recording industry officials are pressuring the government to step up its three-year-old antipiracy efforts.

RINGLEADERS. The industry is offering a carrot to encourage the government. The board of the International Federation of the Phonographic Industry (IFPI) visited Mexico in early October and told officials that if enforcement improved, companies were prepared to invest heavily in promoting Mexican talent for export to the Spanish-speaking world.

The IFPI points to successful efforts against piracy in Asia and argues that Mexico could follow suit by pursuing ringleaders. "History shows when the government cracks down, the effect is



BUSTING THE BOOTY: Mexico has seized 15 million illegal cassettes since 1991

immediate," says Jim Fifield, president and CEO of EMI Music, who predicts that revenues in Mexico could more than triple. The retail value of legitimate CD and cassette sales last year reached almost \$573 million, making Mexico the world's eighth-largest market. If enforcement and investment increase, domestic sales could reach \$2 billion.

U.S. companies have long complained about lax enforcement of Mexican laws protecting intellectual property. Mexico tacked music recordings and computer software programs on to its existing copyright law in 1991. An overhaul of that law, sharpening definitions of piracy and boosting penalties, should go to Congress before the end of 1995.

Still, U.S. execs acknowledge the

Mexican government has made some progress. Officials have raised criminal penalties and set up a central coordinator for the agencies fighting piracy, but they point to limited resources. "Mexico has to move ahead with policy decisions, but I think we're progressing well," says Carmen Quintanilla Macero, director of the copyright office.

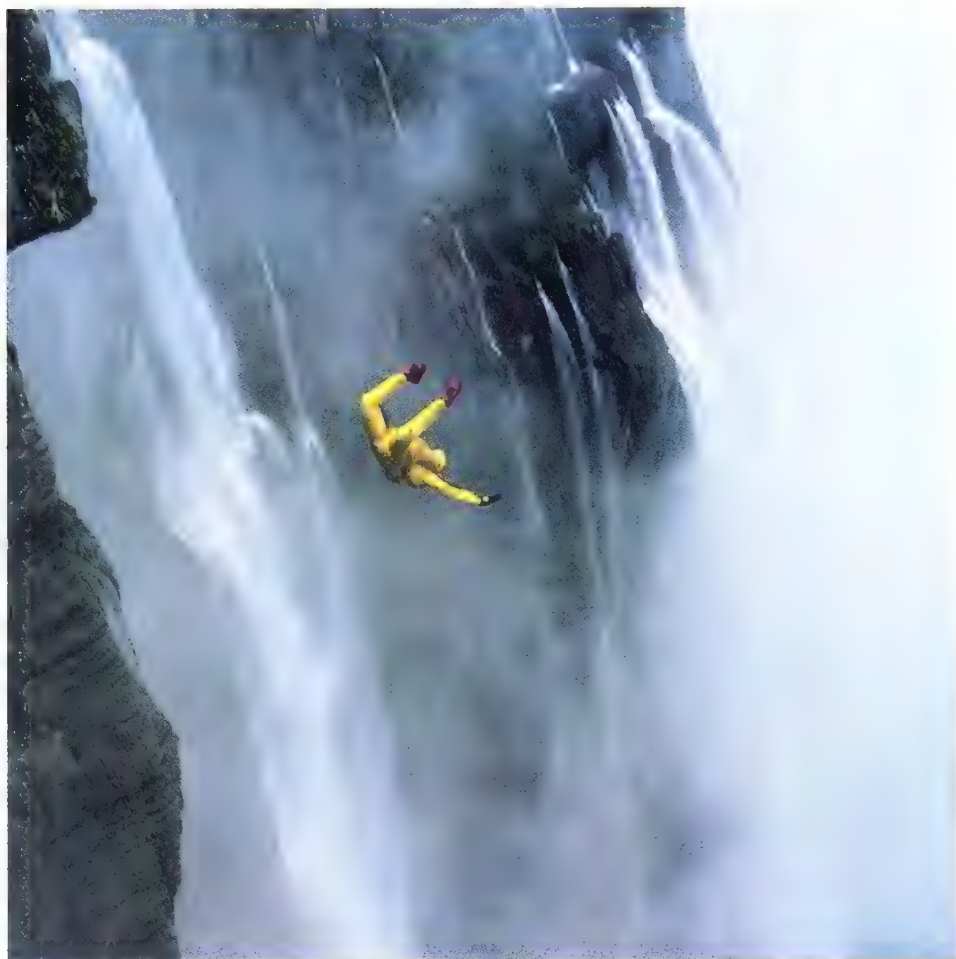
So far, most enforcement efforts involving music have targeted street vendors and backroom pirates. No ringleader has been captured or jailed. Strict enforcement began in earnest at the end of 1991, the government has seized more than 15 million cassettes—and intimidated no one, because penalties are light. "If they come in the morning, I'm back in business by afternoon," says Gerardo Luna, who sells tapes for 75¢ in Mexico City's sprawling Tepito market.

Most Mexicans probably agree with a street vendor who gave his name only as Javier: "Maybe the recording companies are right," he says. "But all we do is sell people a little bit of joy at a good price." Even if the government wants to overhaul piracy, music-mad Mexicans may be harder to win over.

By Elisabeth Malkin in Mexico City

Bootleg tapes now account for two of every three cassettes sold in Mexico

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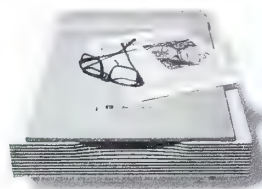


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EDITED BY WILLIAM J. HOLSTEIN

ENDGAME IN IRAQ? WHY SADDAM'S MOVE BACKFIRED

Just four years ago, when the Iraqis blitzkrieged into Kuwait, the Saudis and other wealthy neighbors in the Persian Gulf were gripped by panic. World stock markets crashed, and the price of oil temporarily soared.

Saddam Hussein's threatening buildup in October was worrisome enough for President Clinton to order up the largest deployment of U.S. troops and firepower since the Gulf War. Compared with those tense days of August, 1990, the situation and the broader Middle East are a much changed place. Battling his somewhat rusty saber, Saddam has failed to minimize that reality. Today, Iraq cannot count on a single regional ally. Jordan's King Hussein and Palestine Liberation Organization Chairman Yasser Arafat—both of whom rallied to Saddam's side

—have now been driven closely into the U.S.-sponsored Middle East peace process. There is no need to construct an international coalition to counter Iraq—it's already in place. And while the situation remains a tough one, the primary power combat with its neighbor is a shadow of its former self. The apparent beginning of a troop withdrawal on Oct. 11-12 only

underscored the regime's impotence.

Saddam also badly misjudged Clinton and American resolve. He apparently reckoned that a weakened U.S. President, with his military forewarned in Haiti, either couldn't or wouldn't take the risk of confronting Iraq's forces only a few months before crucial midterm elections. Instead, Clinton handed Clinton a wonderful political standing firm against one of America's least-appealing bullies.

LOSING CONTROL. Why so many miscalculations? Saddam seems to be operating largely out of desperation created by U.N.-backed economic sanctions. Last month, the regime was forced to lift subsidies on basic goods, a move that sent prices soaring in Baghdad. Morale in the 400,000-strong armed forces is low, say Pentagon officials, while spare parts are few and weapons maintenance since the war almost nonexistent. According to intelligence, there have been two attempts on Saddam's life in recent months. "He's bullying Kuwait to try to impose his own people and his own military," says one senior Arabian Foreign Ministry official.

But the move seems to have backfired. Now the prospect of persuading the U.N. to lift sanctions is more remote than ever. And some analysts say they can smell endgame for Sad-

dam. "He is losing control," says Gary Sick, former National Security Council staff member. "The real purpose of the sanctions, though people don't say it, is to bring down Saddam. I think it's working."

Yet Saddam, the Middle East's great survivor, may also be betting that the writing is on the wall for the pro-Western Gulf monarchies. Indeed, since the Gulf War, Kuwait has been convulsed by political squabbling between the ruling Al-Sabah family and the assertive National Assembly. More ominously, chief U.S. ally Saudi Arabia is being buffeted by political stress. An aging King Fahd, an unclear succession, and a sharp rise in religious and political opposition to the ruling Al-Saud clan have been setting nerves on edge. And unlike four years

ago, when it bankrolled Desert Storm to the tune of \$50 billion, the Saudi Treasury is virtually bankrupt.

ETHNIC CHAOS. According to U.S. Treasury estimates, total debt in Saudi Arabia is \$90 billion and rising. A fast-growing population and a political system anchored on buying loyalty through largess have resulted in huge budget deficits. The bottom line: Neither Saudi Arabia nor Kuwait are in a position to bankroll a sustained U.S.-led military presence. That's one reason why Clinton and the Joint Chiefs of Staff are pondering cost-effective preemptive air strikes against Iraqi command and control posts if the troop withdrawals prove to be halfhearted.

The real challenge, however, is what to do about Iraq after Saddam. Should he topple, maintaining order in Iraq is likely to be more politically complicated and expensive than even taking on Saddam in battle. Iraq is an odd amalgam of Shiites vs. Sunnis and Kurds vs. Arabs. It has no unifying ethnic thread.

Even imposing a demilitarized zone in the South near Kuwait could trigger an insurrection by the Shiite Muslims who live in the area and who consider themselves distinct from the Sunni-dominated government in Baghdad. Shiite-governed Iran might take advantage of such a move. Kurds in the North also can be expected to make a push for statehood if Saddam is knocked out, raising a tricky set of issues with key U.S. ally Turkey.

Ultimately, if Iraq were to be dismembered or fragmented, it could set off shock waves that would affect the entire Gulf. There almost certainly would be new flows of refugees, for example, exacerbating ethnic and religious tensions. So even if Clinton makes Saddam Hussein blink now, the challenges of maintaining stability in the world's most important oil patch are sure to grow greater.

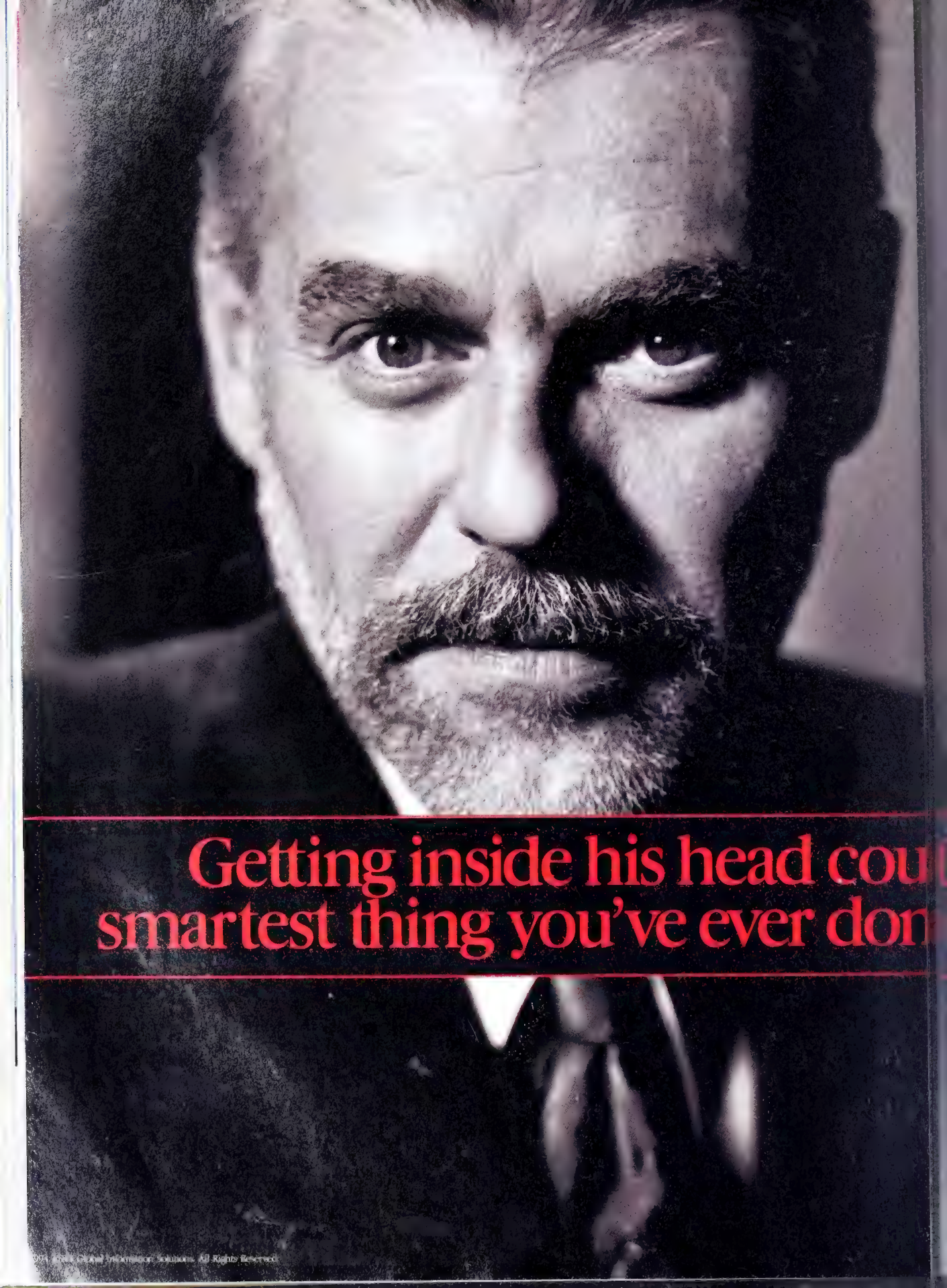
By John Rossant in Rome



BACKING DOWN?



STANDING FIRM



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It seems you can't open a magazine today without reading about the importance of understanding your customers.

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Cover Story

THE BEST B SCHOOLS

Move over, Northwestern—
this time, Wharton is No. 1

When Thomas P. Gerrity was a Massachusetts Institute of Technology student in the early 1960s, he was a solidly built wrestler who regularly muscled his way into the New England championships. In each of his four undergraduate years, however, he managed to capture only third place—even in his senior year when he went to the mat as captain of MIT's squad.

Gerrity, dean of the University of Pennsylvania's Wharton School, isn't in third place anymore. The onetime entrepreneur has now led Wharton to a No. 1 finish in *BUSINESS WEEK*'s ranking of the best graduate schools of business. Wharton unseated Northwestern University's J.L. Kellogg School of Management, which has held the top spot through three consecutive biennial polls since 1988.

Gerrity pinned the opposition by boldly pushing the most dramatic curriculum changes at any elite school. Those changes helped Wharton secure the top grade from Corporate America, which singled out the school for having launched the most innovative curriculum in recent years. And by paying far greater attention to student demands for better teaching, Gerrity also gained the third-best marks from Wharton's own graduates.

Wharton's surge from the No. 4 slot in 1992 wasn't this year's only surprise. Harvard University's Graduate School of Business Administration slumped two places, to No. 5, its lowest ranking ever. Stanford finished fourth, up from seventh. Dartmouth College's Amos Tuck School of Business Administration fell to 13th from 6th because of lower ratings from this year's graduating class. Two business schools—Vanderbilt University's Owen Graduate School of Management and Washington University's John M. Olin School of



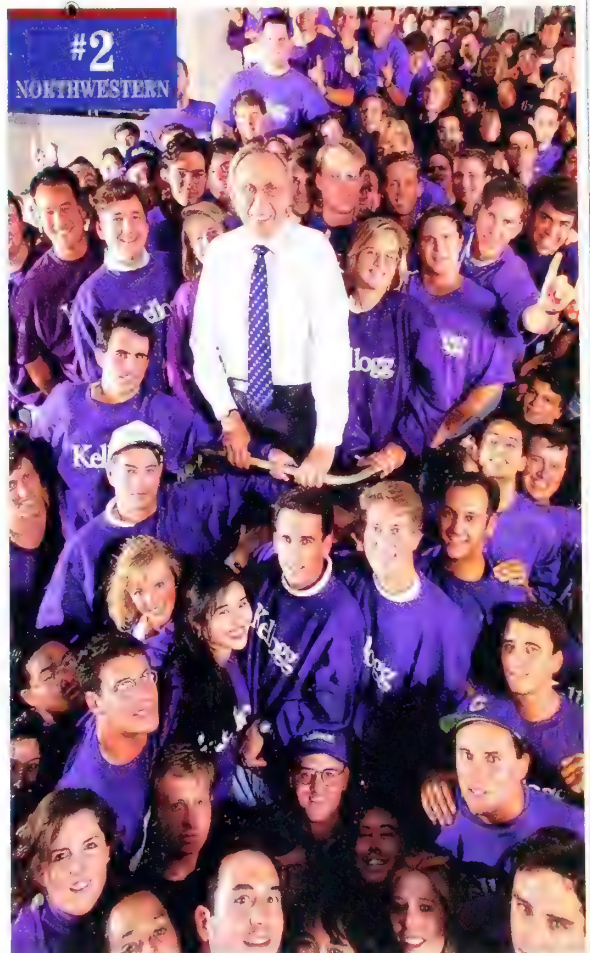
Robert Hamada
Chicago

Michael Spence
Stanford





Thomas Gerrity
Wharton



Donald Jacobs
Northwestern



Joseph White
Michigan

John McArthur
Harvard

Business—fell off the list altogether, largely because of graduate dissatisfaction. They were replaced by the University of Texas Graduate School of Business at Austin and Purdue University's Krannert Graduate School of Management.

the first year. They're adding courses in teamwork and leadership and placing greater emphasis on globalization and quality.

They're also making business education more pragmatic and less theoretical by adding real-world consulting projects and field assignments to the curriculum. Through it, students are made active participants in the effort to change, rather than passive bystanders. "The old business-school model was like a Broadway show that students sat back and watched," says B. Joseph White, dean of the University of Michigan's business school. "We're turning up the lights and opening up the curtains so that when students get here they're going to be actively involved in their education."

BUSINESS WEEK's rankings are sensitive to such changes because the survey adopts the consumer's perspective in measuring the quality of business education. Instead of evaluating schools on test scores and starting salaries, the magazine sent extensive surveys to 6,353 of this year's graduates of prominent schools and to 354 companies that actively recruit MBAs at the top schools. A total of 4,608 graduates and 28 companies responded (page 70).

Graduates, who judged only their own schools, were asked for their views on such issues as teaching quality, program content, and career placement. In the corporate survey, recruiters were asked to rate student skills and to rank schools on their overall quality and the success rate of graduates in their organizations. Both polls were combined to produce the BUSINESS WEEK ranking.

It's not always possible to assess a school's immediate progress by a one-time change in its rank, though. The U

Cover Story

THE BEST B-SCHOOLS

arguably the most successful business school dean of this era, established the model of the modern business school in the early 1980s, when such traditional, elite schools as Harvard, Stanford, Chicago, and Wharton were content to ignore market demands for MBAs who could better lead and motivate others. Sure enough, corporate recruiters still praise Kellogg for producing graduates who are best in their ability to work in teams and in their interpersonal skills.

"TURNING UP THE LIGHTS." But Jacobs has resisted any pressure to overhaul his program again. "We've developed a learning organization, and that means we continually change and don't need to have massive changes periodically," he says. Still, Wharton was able to nudge out Kellogg as the No. 1 school largely because of strong market approval of its innovative efforts.

Wharton is on the crest of a wave of reinvention and change in management education. Schools are tearing apart their programs to rethink ways to educate the next generation of business leaders. As at Wharton, some are trying to teach business as a complex whole instead of a set of disparate functions—even handing out only one grade per semester in

A Report Card of the Top 20

WITH THE CONTINUED DOWNSIZING of Corporate America, you would think the market for freshly minted MBAs would be drying up. Forget it. A quick scan of this year's guide shows that the Class of 1994 cleaned up in the job sweepstakes.

Graduates of every school averaged starting salaries that hit record levels, and they entertained far more job offers than the Class of 1992. Harvard MBAs again commanded the highest average starting pay: an eye-popping \$102,630.

The report card measures schools also by the graduate and recruiter surveys. The top 20 in each category received A's. The next 25% got B's, the next 35% got C's, and the bottom 20% got D's. For further details on the ranking process, see page 70.

1994 RANK	SCHOOL	1992 RANK	CORP. POLL	GRAD. POLL	ANNUAL TUITION**	APPLICANTS ACCEPTED	ENROLLMENT INT'L
1	PENNSYLVANIA (Wharton) Philadelphia	4	1	3	\$21,050	23%	30%
2	NORTHWESTERN (Kellogg) Evanston, Ill.	1	2	5	20,634	20	24
3	CHICAGO Chicago	2	4	4	21,656	33	16
4	STANFORD Stanford, Calif.	7	5	1	21,189	10	21
5	HARVARD Boston	3	3	17	21,000	16*	26
6	MICHIGAN Ann Arbor	5	6	7	20,960	35	15
7	INDIANA Bloomington	8	8	6	14,036	48	14
8	COLUMBIA New York	9	7	10	21,400	25	27
9	UCLA (Anderson) Los Angeles	16	16	2	14,496	23	20
10	MIT (Sloan) Cambridge, Mass.	13	9	12	21,690	25	35
11	DUKE (Fuqua) Durham, N.C.	12	14	8	20,800	26	17
12	VIRGINIA (Darden) Charlottesville	11	15	9	17,839	27	13
13	DARTMOUTH (Tuck) Hanover, N.H.	6	12	14	21,225	17	19
14	CARNEGIE-MELLON Pittsburgh	17	18	11	20,600	35	41
15	CORNELL (Johnson) Ithaca, N.Y.	14	17	13	20,400	37	29
16	NYU (Stern) New York	15	13	20	20,276	40*	34
17	TEXAS Austin	NA	11	25	8,580	35	19
18	UNC (Kenan-Flagler) Chapel Hill	10	19	16	10,132	22	13
19	CALIFORNIA (Haas) Berkeley	18	21	15	14,361	20	29
20	PURDUE (Krannert) West Lafayette, Ind.	NA	10	33	9,556	32	28

*Estimate

**For nonresidents

DATA: BUSINESS WEEK (RESEARCH BY LORI BONGIORNO, JUDI CROWE, LOURDES HERNANDEZ, AND JEFFREY

ty of Michigan, for example, slipped one this year, to sixth, only because Stanford ed ahead by capturing the highest acco- from its graduates. However, corporate nters said Michigan's MBAs have shown greatest improvement of any in recent s and also singled out the school for hav- launched what they regard as the second- -innovative curriculum—behind only rton's. Michigan was also the only school ke the top five in turning out the best uates in every key category: general man- ent, marketing, finance, and production e, page 67).

FORCE. And what about all those reports nterest in MBA education has fallen in re- years? Hardly: BUSINESS WEEK found that was an extraordinarily bullish year for the leading schools and their graduates.

ications at most of the top MBA programs are rising, y with revenues from executive-education efforts. And anies are charging back to campus in full force. Recruit- sponding to BUSINESS WEEK's survey hired 6,569 MBAs ear, up 18% from 1993.

e result: Even before graduating, MBAs from Top 20 ls this year averaged 2.74 job offers each. And they ed positions with average starting pay and bonus of 24—up 36% from 1992, thanks largely to the highly ag- ive recruiting efforts of consulting firms. Indeed, for irst time ever, graduates at three schools—Harvard,

Wharton is on a crest of change in management education and gets high marks for emphasizing "people skills" and real-world problems

Stanford, and Columbia—averaged starting pay packages in six figures. So much for the MBA glut (page 71).

The good times, however, provided little respite from the continuing battle of the busi- ness schools for reputation and prestige. Washington University's Olin School lost its Top 20 status because its graduates grouched about the loss of three of the school's top 10 teachers in the past two years. "Olin leaves me with the impression that it is long on pre- tensions and short on substance," said one graduate. It didn't help that the school has been without a full-time, permanent dean since March of 1992.

Vanderbilt University's Owen Graduate School of Management, No. 19 in 1992, also skidded off the Top 20 list. The Class of 1994 believed Dean Martin S. Geisel failed to ade-

quately manage a scandal that erupted earlier this year when an MBA embezzled about \$3,000 from the student treasury. Some grads thought Geisel should have either suspended the student, who pleaded guilty to the charge, or withheld his MBA degree. Instead, he was allowed to graduate after returning the money and performing some community service. "Some students got highly agitated about the matter and felt the guy wasn't being punished at all," says Geisel. "We followed estab- lished disciplinary procedures to the letter."

Harvard's star also plummeted as it placed 17th in the graduate poll, down from No. 12 in 1992. MBAs judged the

RANK BY ST-MBA	WITHOUT JOB OFFER	AVERAGE JOB OFFERS		MBA SKILLS GRADED BY RECRUITERS			SCHOOLS GRADED BY GRADUATES		
				ANALYSTS	TEAM PLAYERS	GLOBAL VIEW	TEACHING	CURRICULUM	PLACEMENT
19,930	1.7%	3.02	Companies say Wharton has most innovative new curriculum of any school and is now Corporate America's favorite MBA hunting ground	A	B	A	C	A	A
14,640	6.1	2.96	Recruiters still rate Kellogg grads best in interpersonal skills and team-work; moved MBA program into new \$30 million building this year	A	A	A	B	A	A
13,210	2.7	2.92	New dean is aggressively moving to become international player; launched executive MBA program in Spain and new global MBA option here	A	B	A	B	A	A
10,800	1.3	3.47	MBAs praise cooperative culture & entrepreneurial mind-set, making Stanford No. 1 in grad poll; 54% of class landed six-figure pay deals	A	C	A	B	A	A
12,630	2.0	3.60	Grads earn highest pay packages but grouse about unresponsive admin- istration and plodding effort to revamp curriculum	A	B	A	B	A	B
17,820	7.1	2.68	Recruiters say school ranks second in having launched most innovative program in recent years and first in turning out most improved MBAs	A	A	B	B	B	A
18,520	7.2	2.45	Corporate America loves school for its highly competent, inexpensive, no-nonsense MBAs; program innovations have improved teaching in core	B	A	C	A	B	B
10,480	4.3	2.43	Dean has vastly enhanced program and gained O.K. for plans for a new building; grads averaged six-figure pay packages thanks to Wall Street	B	B	A	C	C	A
14,010	2.1	2.74	New dean put school on solid financial footing after deep cutbacks in state aid; now boasts own kitty to fund student-launched ventures	C	A	B	A	A	A
10,500	2.6	3.25	Recruiters rate grads best in analytical skills; new dean now gives students option to skip thesis and awards an MBA degree for first time	A	C	B	C	B	B
10,490	4.2	2.78	Longtime dean who led school to national prominence stepping down in mid-1995; leaves school in great shape with a revamped curriculum	B	A	C	C	B	A
14,280	2.4	2.69	Grads award faculty top teaching honors in survey; new ex-investment-banker dean will try to improve corporate connections	C	A	B	A	A	B
15,410	4.8	2.40	Abrupt ouster of dean exposed students to politics at school known for its harmonious culture; has devoted alumni network	C	A	C	A	B	C
19,890	2.6	2.69	Dean begins turnaround of school that dropped eight places in 1992 ranking because of student dissatisfaction	A	C	C	B	C	B
11,970	5.1	2.40	Trying to strengthen manufacturing niche; added novel "Semester in Manufacturing" with field trips, projects, and team teaching	B	B	C	A	B	B
10,660	14.3	2.12	New dean in new building with new MBA program, trying to vastly improve teaching quality for street-smart students	B	A	B	C	C	B
11,890	12.0	2.58	Back in Top 20 after two-year absence, partly because of emphasis on more experienced MBAs; gung-ho students enlist corporate support	B	B	C	C	C	C
19,880	5.7	3.09	Slow transition to new dean led to tumble in corporate ranking, but school offers superb value and great teaching	B	B	B	A	B	C
11,970	9.7	2.34	Moves into new, attractive complex in 1995; offers overseas consulting projects for MBAs; Clinton has lured many Berkeley scholars to capital	B	C	B	C	B	B
14,720	7.0	2.19	Newcomer to Top 20 gets high grades from industrial companies for its MBAs with manufacturing knowhow, but lags in student satisfaction	B	B	C	D	D	C

administration the least responsive of any Top 20 program. They also felt less confident about their analytical and technical abilities than other grads. Some MBAs further complained about the slow pace of change at the school and what

they called "exorbitant fees" for everything from case materials to student housing. "This school is like an archaic

dinosaur that needs to take its own advice," said one 1994 graduate.

As for Wharton, founded by Philadelphia industrialist Joseph Wharton in 1881, its ascendancy was no overnight feat. It began when Russell E. Palmer, the former chief executive of accounting firm Touche Ross International, agreed to come aboard as dean in 1983. The charismatic Palmer mounted a campaign to make Wharton "the world's preeminent business school," a phrase he intoned so often that MBAs began to parody it at their annual follies show.

NEW TONE. To meet his goal, Palmer shook up the Establishment by offering hefty salaries to lure dozens of bright faculty members to the classroom. Over a seven-year period, he tripled the school's endowment to \$90 million, adding 27 endowed chairs. He put Wharton in the executive-education business by building a plush \$25 million center with 19th century Burmese tapestries and Salvador Dali lithographs. And Palmer began an extensive review of the school's MBA program that eventually led to vast changes in its curriculum. "Palmer provided vision and leadership," says Jerry Wind, a marketing professor. "He was a builder."

When the dean retired in 1990, all the pieces were in place for Gerrity, a former MIT professor and a founder of the Cambridge (Mass.) consulting firm now known as CSC Index Inc. Gerrity quickly provided the support and leadership to get a new curriculum off the ground, phasing the changes in over a two-year period starting in 1991. "A lot of the faculty here asked, 'Why are we doing this?'" recalls Wind, a principal architect of the new program. "They said, 'Everything is fine. Why should we change?'"

Gerrity had no doubts. Wharton, which had held sway as the school of high finance throughout the roaring Eighties, had not revamped its rigid, analytical approach to management education since the early Sixties. He believed the school needed to place greater emphasis on "people skills" and real-world problems, add more global perspective, and teach business not as a set of distinct disciplines but in a more integrated fashion. "I'm proud that we've had the courage to take the leadership in curriculum change and to move early and significantly," says Gerrity. "I think it set a tone for the entire business-school community."

To be sure, some schools, most notably the University of Tennessee



at Knoxville and Indiana University, have since adopted more radical approaches to overhauling their MBA programs. But Wharton, given its status as one of the elite players, clearly assumed greater risk in remaking its curriculum so dramatically. A plodding two-year-old effort to redo Harvard's curriculum, by contrast, has so far failed to bring about any substantial changes.

HEAVY WORKLOAD. Three years ago, Wharton launched a four-week "pre-entry" program of courses, computer lab speeches, social activities, and an Outward Bound-like experience in the Poconos. The usual two semesters a year were tossed aside in favor of four six-week "modules," requiring every first-year course to be reevaluated for content and relevance. A novel series of leadership and ethics programs runs throughout the first year. To integrate the core course, key faculty are brought together on a regular basis to ensure that what is taught in marketing, say, can be quickly linked to operations. Team assignments, computer simulations, multidisciplinary case studies, a field project, and a four-week trip abroad also were added.

In some ways, however, the makeover has been too ambitious. The changes heaped so much more work on the students that the faculty have since had to scale back additional course requirements, exams, and leadership exercises. The overseas excursion, initially meant to be a mandatory month-long immersion in the culture, politics, and business of another region of the world, has since become voluntary because not all students can afford the \$4,000-to-\$4,500 cost. And the much ballyhooed integration of the core curriculum has run into serious obstacles at a school where the faculty is divided among 12 departments and 21 research centers. "We are used to operating as individuals, managing our own course designing our own syllabi, and teaching in our own styles," says David J. Reibstein, a former vice-dean.

Indeed, BUSINESS WEEK's graduate survey shows that six schools as Virginia, Indiana, Michigan, and Stanford have achieved far greater levels of satisfaction among their MBAs.

The Up-And-Comers

The schools recruiters say are coming on strong

MOST INNOVATIVE CURRICULUM

- | | |
|------------|------------------|
| 1 WHARTON | 4 INDIANA |
| 2 MICHIGAN | 5 NORTH CAROLINA |
| 3 COLUMBIA | |

PROGRAMS SHOWING GREATEST IMPROVEMENT

- | | |
|------------|------------------|
| 1 MICHIGAN | 4 TEXAS |
| 2 CHICAGO | 5 NORTH CAROLINA |
| 3 DUKE | |

MOST FREQUENT ADDITIONS TO RECRUITING PROGRAMS

- | | |
|------------------|-----------|
| 1 MICHIGAN | 4 TEXAS |
| 2 WHARTON | 5 DUKE* |
| 3 NORTH CAROLINA | VIRGINIA* |

DATA: BW SURVEY OF RECRUITERS



**SATISFACTION:
STANFORD
MBA STUDENTS**

curriculum integration issue. Virginia and Stanford, much smaller business schools, have no distinct departments. Indiana and Michigan have both made integration a part of their revamped curriculums. But Gerrity and at least one other member of Wharton faculty seem dedicated to the status quo. "This is a slow, evolutionary process," insists John W. Sweeney, an operations professor who is one of four "clusters" who coordinate faculty within the core. "But it is a slow process. As faculty, we meet more often and in smaller groups of people who will see the same subset of students in the program."

To monitor progress and perhaps keep the pressure on, Wharton has contracted with Opinion Research Corp. to do comprehensive polling and focus-group interviews of MBAs, alumni, and corporate recruiters. And while Gerrity is much more reserved and cerebral than the gregarious Palmer, he makes himself more accessible to students. Each semester he holds six brown-bag luncheons in the MBA pub, as well as a more formal forum with students on the state of the school. On the last day of classes, Gerrity hosts a champagne reception on the grassy quad in front of Vance Hall to honor the school's best teachers. "The ceremony is quite moving," says Sweeney. "It's beautiful. It's about the spirit of the school and it shows the true teaching excellence."

They say it's a tough time. For example, Wharton graduates have complained about the quality of the teaching. An initiative to improve it

GRADS' CHOICE

At Stanford, which cultivates a cooperative environment, it's not uncommon for study groups to take place in students' hot tubs

has led to faculty mentors, midcourse evaluations, merit-pay increases pegged to teaching quality, student quality-circles that offer weekly feedback to instructors for every course, and an array of new teaching awards.

Such improvements have helped Wharton attract its best students ever. This year's entering class—from 56 countries—posted Wharton's highest average score—650—on the GMAT (Graduate Management Admission Test). Gerrity has also brought in an addition-

al 14 endowed chairs, helping to lift the endowment to \$141 million. And he has implemented Palmer's dream of making Wharton a major player in executive education, which drew \$22.6 million in revenues in the past year.

"FRIENDLY ENVIRONMENT." While Wharton has emerged as the "preeminent business school," it's still not No. 1 in graduate satisfaction. For the first time, that honor goes to its cross-country rival, Stanford, a school less than half Wharton's size. Stanford deemphasizes individual competition and cultivates a highly cooperative learning environment. Unlike Harvard, there's no forced grading curve. Nor are grades publicly posted or allowed to be disclosed to corporate recruiters. "It's a very friendly environment," says Van Ton, a second-year student. "You could be competing for the same jobs, and you'll still help each other."

The school has long been the most selective MBA program in the world, accepting only 1 in 10 applicants, and it's known for an exceptionally diverse pool of students. This year's entering class of 364 MBA candidates include two Jesuit priests, a stand-up comedian, and a national powerlifting champion. Students at "the farm"—the nickname is a throwback to a century ago, when the campus was a racehorse-breeding ranch—often share rented palatial homes equipped with hot tubs where study groups sometimes meet.

More important than the laid-back California lifestyle, the school's location in sun-drenched Silicon Valley makes it a haven for would-be entrepreneurs. One graduate remembers a meeting at which Scott McNealy, founder of Sun Microsystems Inc., agreed to show up at a student's home for an entrepreneurs' club session. With a beer in hand, McNealy regaled 150 students with his insights into the future of technology.

Those attributes have always been a hallmark of Stanford's program. But the uneven quality of teaching had previously held it back from gaining the top spot in BUSINESS WEEK'S

Favorite Hunting Grounds

Where companies say they find the best graduates for specific skills

GENERAL MANAGEMENT		MARKETING	FINANCE	PRODUCTION
1 HARVARD	6 COLUMBIA	1 NORTHWESTERN	1 WHARTON	1 CARNEGIE MELLON
2 NORTHWESTERN	7 WHARTON	2 MICHIGAN	2 CHICAGO	2 PURDUE
3 STANFORD	8 NORTH CAROLINA	3 HARVARD	3 COLUMBIA	3 MICHIGAN
4 MICHIGAN	9 INDIANA	4 NORTH CAROLINA	4 NEW YORK	4 MIT
5 VIRGINIA	10 DUKE	5 VIRGINIA	5 MICHIGAN	5 CORNELL

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graduate satisfaction poll. Credit for the improvement goes to Dean A. Michael Spence, who arrived in late 1990 from Harvard, where he headed the faculty of Arts and Sciences. He has developed new teaching workshops to train incoming faculty. All new professors are assigned senior faculty mentors and must now co-teach a course with a more experienced faculty member in their first year.

Stanford MBAs praise Spence for being active and responsive. In the spring of 1993, for example, four students asked the dean for a global management program that would award a certificate to graduating students who completed a sequence of four courses on international topics. Within three months, Spence implemented the proposal. He has also launched 20 new courses in the past two years and forged new links to Stanford's engineering school, a relationship that has created a jointly designed, two-quarter course that brings together students

from both schools to design, produce, and market a product. Besides such efforts, Stanford's ranking also benefited from another school's stumble. Dartmouth's Amos Tuck School, the quaint, New England version of Stanford's cozy, collegial culture, saw its image tarnished when Dean Edward Fox was denied a second four-year term by the college. His abrupt departure exposed students to what they called the "petty politics" of a few outspoken faculty members who wrote critical letters about the dean to the president. Tuck's small size and its remote location in Hanover, N.H., make it difficult for the school to attract many corporate recruiters—a reason the school doesn't fare better than a No. 1 ranking in the corporate poll.

It all goes to show that in the world of business schools, in the world of business, nothing can be taken for granted. That's something Gerrity learned on a wrestling mat. So something he's keeping in mind for the next match of the best business schools.

By John A. Byrne and Lori Bongiorno in New York

Cover Story

THE BEST B-SCHOOLS

THE METHOD TO OUR MATH

Since its debut in 1988, BUSINESS WEEK's ranking of the Top 20 graduate schools of business has become a much discussed and influential source of information on management education. One reason the ranking is so closely followed is that it measures how schools satisfy the needs of their two major stakeholders: graduates and the corporations that hire them.

To ensure the best results, Matthew Goldstein, an expert in survey design and a co-author of several books on statistical methods, again consulted on all aspects of the polling process.

■ GRADUATE SURVEY.

A 36-question survey was mailed to this year's graduates of 44 top schools, including three non-U.S. schools. MBA candidates were selected at random from class lists. Of the 6,353 questionnaires sent out, 4,608 were answered, a response rate of 73%.

Graduates were asked to answer most questions on a scale of 1 to 10. One example: "How would you judge the school's performance in providing you with numerous ways of thinking or approaching problems that will serve you well over the long haul?" Those MBAs who thought the school did an "outstanding" job would an-

swer "10," while graduates who believed the school's performance was "poor" would answer "1." The responses were weighted to account for how closely they related to overall satisfaction.

BUSINESS WEEK then added the responses of 4,712 graduates from its 1992 poll and 3,664 from its 1990 poll to create a graduate ranking. The most weight, 50%, went to the 1994 survey. Responses from the previous surveys got a weight of 25% each.

■ RECRUITER SURVEY.

A total of 354 organizations that recruit MBAs were polled. Of those, 254 replied, a response rate of 72%. Responding companies hired 6,569 MBAs this year, up 18% from 1993. Some 39% of them are headquartered in the Northeast, 29% in the Midwest, 16% in the South, and 15% the West.

Recruiters were asked to list a Top 10, in order, based on the quality of the schools and their company's success rate with their graduates. A school named No. 1 received 10 points, while a school ranked No. 10 got 1 point. The total score for a school was then divided by the number of responding companies that recruited MBAs from the school. Because the larger schools attract more companies, ratings for some of the schools (11 of the Top 20) were adjusted upward to account for

the large-school bias.

■ COMPOSITE RANKING. To produce an overall ranking, the raw scores from both surveys were combined using a standard statistical approach for independent scores.

The survey's prominence has led some efforts to influence the results. At Columbia University, for example, students organized a letter-writing campaign for first-year MBA candidates. Nearly 85 students sent personal letters to BUSINESS WEEK praising the program. The effort, however, had no impact on the survey because only graduating students are polled.

At Indiana University, the student association president encouraged classmates to "accentuate the positive" in survey responses. Any one-time effort to influence the survey would have little impact, however. The graduate ranking is based on randomly sampled opinions of 12,984 MBAs dating to 1990. In Indiana's case, the graduate rank this year remains unchanged. In addition, recruiter opinion naturally looms larger in the overall ranking because the differences in the corporate poll are greater than those in the graduate survey.

The evidence also shows that schools frequently fall due to poor reviews from graduates: They average 28 years of age and are fairly discriminating after investing \$40,000 or more in tuition. This year, Dartmouth and Harvard dropped because of graduate dissatisfaction, and two other schools fell out of the Top 20. As Indiana Dean John Rau puts it: "The last thing you do is tell 27-year-olds what to do."

The Survey

GRADUATE POLL

	1992	1994
SURVEYS	6,046	6,353
REPLIES	4,712	4,608
RESPONSE RATE	78%	73%

RECRUITER POLL

	1992	1994
SURVEYS	352	354
REPLIES	199	254
RESPONSE RATE	57%	72%

DATA: BUSINESS WEEK

IS THERE AN MBA GLUT? IF YOU ANSWERED NO, YOU PASS

are getting degrees—and hefty stock options, tuition refunds, signing bonuses...

Don't talk to Michael Lesyna about either an MBA glut or declining demand for the prototypical yuppie degree. Like many in a class of 1994, the Stanford graduate doesn't pay this year when Booz, Allen & Ton lured him to the firm with a first-year salary in six figures. "It would have taken forever to get to where I am now," says Lesyna. "The opportunity and the value of an MBA is clearly there."

Not kidding. Not since the roaring 1980s, when Drexel Burnham Lambert Inc. flew to Pebble Beach to listen to \$100,000 a year has the market been so overheated. Lesyna stamped at Harvard or William & Mary for the sheepskin that nearly everyone has been losing its cachet only a year ago is setting a new record starting salaries for its graduates, thanks largely to a boom in consulting firms like free agency in baseball, without a salary cap," says Robert McIlhattan, a partner at Ernst & Young, which hired more than 1,000 MBAs in 1994. "I've seen some wild things in the market."

GRADUATES' CHOICE. Even as downsizings continue, corporate recruiters are dangling packages of pay and perks to lure the top talent. For the first time in a decade, MBAs from Harvard and Stanford led in median starting pay and bonus packages of \$100,000 or more. To attract the graduates, companies handed out signing bonuses as high as \$30,000, plus interest-free loans, stock options, tuition reimbursement of up to \$40,000, free cars, and relocation allowances.

The increased demand for leading graduates is letting many MBAs be quite choosy. For Lim, a 1994 University of Michigan graduate, he entertained nine offers before deciding to join up with the treasury office at Generators Corp. "Among the top business schools," says Lim, "there is, if anything, a glut of MBAs."

What happened to that much expected glut? Although many have been predicting a shakeout for a decade, not a single MBA school has closed its doors. A record 84,642 masters degrees were granted in 1992, the latest year for which figures are available, an 8% rise over the previous year. "It's like a phoenix with nine lives," says Charles W. Hickman, an official with the American Assembly of Collegiate Schools of Business. "Every time you start a funeral, the corpse jumps up." Schools are reporting increases in applicants. Duke University's Fuqua School of Business saw applications rise by 10% for this year's entering class. At Stanford, they were up 15% after a falloff the previous year. At Columbia, applications jumped 14%—with the fastest-growing pool of candidates coming from the U.S.



THE LESYNAS:
(CLOCKWISE) MIKE,
KAREN, JENNIFER,
KATIE, KRISTINE

“There is absolutely no question in my mind that I made the right decision.”

—MICHAEL LESYNA, Booz Allen

What some observers interpreted as a sign of a decline in the value of the MBA a year or two ago is increasingly being viewed as little more than a recession-induced downturn. Fewer people took the Graduate Management

Admission Test and applications at some schools declined in 1992 and 1993 because potential candidates for the degree were less likely to quit jobs during a time of economic uncertainty. "Demand for MBAs from the quality schools isn't going to fall away," says Meyer Feldberg, dean of Columbia University's business school.

Instead, Feldberg foresees the possibility of another boom in MBA education as applications flow in from such rapidly industrializing nations as Argentina, Brazil, China, India, Mexico, and Eastern Europe. "What's going to happen in three years' time when each of the top 20 schools get 400 to 500 applications from China alone?" he asks.

Some business schools are already witnessing the early stages of such a boom. The University of Pennsylvania's Wharton School of Business got 133 applications from stu-

dents in China for this year's entering class—more than three times the number of just two years ago. Applicants from Mexico jumped by 162%, to 118, while those from India rose by 42%, to 255, over the same period.

Cover Story

THE BEST B-SCHOOLS

with badly needed skills to run modern businesses. At the moment, though, virtually all of the demand for today's graduates is from U.S.-based multinationals. The biggest recruiters are management-consulting and investment-banking firms, which are crowding mainstream consumer-product and manufacturing companies out of the best business schools. A record 34% of Northwestern's graduates rushed into consulting this year, up from 29% in 1993.

FOOD FOR THOUGHT. Consultants and bankers did some intense wining and dining this year. "You could make it through all fall quarter without cooking dinner," jokes Teri-Lynn Judge, a Stanford graduate who joined Electronic Data System Corp.'s management-consulting arm. Ernst & Young, she says, invited MBA candidates to a San Francisco culinary school, where they cooked up gourmet dishes with the firm's partners. McKinsey & Co. rented a local bowling alley for first-year students at Stanford and brought in blackjack and roulette tables for a casino night for second-year pupils.

Investment bank Lehman Brothers Inc. invited Victor L. Vescovo, a Harvard MBA, to dinner with its chief executive officer at a swank Boston restaurant. He chose to take a six-figure pay package with consultant Bain & Co. Most of Vescovo's classmates also became consultants or investment bankers. "The manufacturing companies have sticker shock from new MBAs," he says. "They're not used to competing for people who have multiple job offers."

Sure enough, BUSINESS WEEK's analysis of graduates earning \$100,000 and up right out of school shows they're almost always hired by the high-end consulting firms (table). With the exception of investment banker Goldman, Sachs & Co., all of the top 10 employers offering six-figure deals to this year's crop of MBAs were consultants. "In our business, we've got to get the real high-end talent because the payoff is enormous when you get it," says Paul A. Brand, chief executive of American Management Systems Inc. "Intellectual horsepower is fundamental to our growth."

For these newly capitalist or developing economies, U.S. business schools can provide future managers

Awarding big premiums for young talent has its drawbacks. A major one is the morale problem that comes when newly hired MBAs are paid more than people who have been with a firm for a long time, says McIlhatten of East & Young's consulting practice. "And today, it seems like everyone knows what they make. Years ago that used to be taboo. As soon as everyone else knows, my office has a line outside it."

To blur such discrepancies, many consulting firms are adding the packages with all kinds of bonuses while trying to keep base salaries under control. One of the most popular bennies this year is reimbursing students for a year's worth of tuition—a benefit of \$20,000—if they sign up after doing a summer internship. "This is something I have never seen before," says Thomas F. Keller, dean of Duke's business school. To compete, some nonconsulting firms are offering different, if less costly, perks. American Airlines offered some graduates a round-trip ticket to fly anywhere in their system.

The most lucrative offers, of course, are lavished on graduates of the very best schools. But even institutions with the glamour of a Dartmouth or a Northwestern found their

graduates earning record salaries this year. "It's a seller's market at the top business schools and a real strong market at the next tier down," says Maury Hanigan, a New York-based consultant who helps companies recruit MBAs. At the College of William & Mary, for example, the percentage of MBAs quickly landing jobs has risen every year for the past five years, to 36% for the Class of 1994. "Our graduates should increase their lifetime earnings by \$300,000 because of the MBAs," figures Alfred N. Page, dean of the college's business school.

Even so, deciding whether or not to go for the degree can be a difficult decision. Many prospective students already hold good jobs that pay \$30,000 to \$50,000 a year. Stanford's Lesyna had been working as an engineer for AlliedSignal Inc. division for nine years when he decided to go for an MBA at the age of 31. He quit his well-paying job, moved his wife and three small children from Germany to California, and lived off 401(k) money and his wife's nursing salary during the two-year stint at Stanford. "It's a tough being out of work for two years," says Lesyna, "but there is absolutely no question in my mind that I made the right decision." For Lesyna and many of his classmates, the proof is in the paycheck this year.

By Lori Bongiorno and John A. Byrne in New York

How To Make Six Figures Right Out Of B-School

Of the 4,608 MBAs in the Class of 1994 who responded to BUSINESS WEEK's survey, 594 said they would earn \$100,000

TOP B-SCHOOLS

RESPONDENTS FROM CLASS OF '94 WITH SIX-FIGURE PACKAGE

STANFORD	53.7%
HARVARD	52.1
DARTMOUTH	39.2
WHARTON	33.3
NORTHWESTERN	30.8

TOP UNDERGRADUATE SCHOOLS

SHARE OF ALL SIX-FIGURE GRADS

BERKELEY	3.2%
PENNSYLVANIA	2.9
DARTMOUTH	2.7
HARVARD	2.7
STANFORD	2.7

TOP CAREER PATHS

CONSULTING	46.3%
FINANCE	13.6
INVESTMENT BANKING	8.8
GENERAL MANAGEMENT	5.1
MARKETING	3.7

DATA: BUSINESS WEEK

or more in salary, signing bonus, and other compensation in their first year of work. The MBA who lands a six-figure package is most likely to be: male (81%), 28, a graduate of Stanford Business School, and one of McKinsey & Co.'s 300 recruits this year.

TOP UNDERGRADUATE MAJORS

ENGINEERING	21.9%
ECONOMICS	19.2
FINANCE	9.1
BUSINESS	5.2
ACCOUNTING	3.4

TOP RECRUITERS

SHARE OF ALL SIX-FIGURE GRADS

MCKINSEY	10.4%
BOOZ, ALLEN & HAMILTON	7.2
BAIN	4.7
BOSTON CONSULTING GROUP	4.2
GEMINI CONSULTING	4.2

THE B-SCHOOL PROFS AT THE HEAD OF THEIR CLASS

Enthusiasm, preparation, and an abiding effort to transfer knowledge set them apart

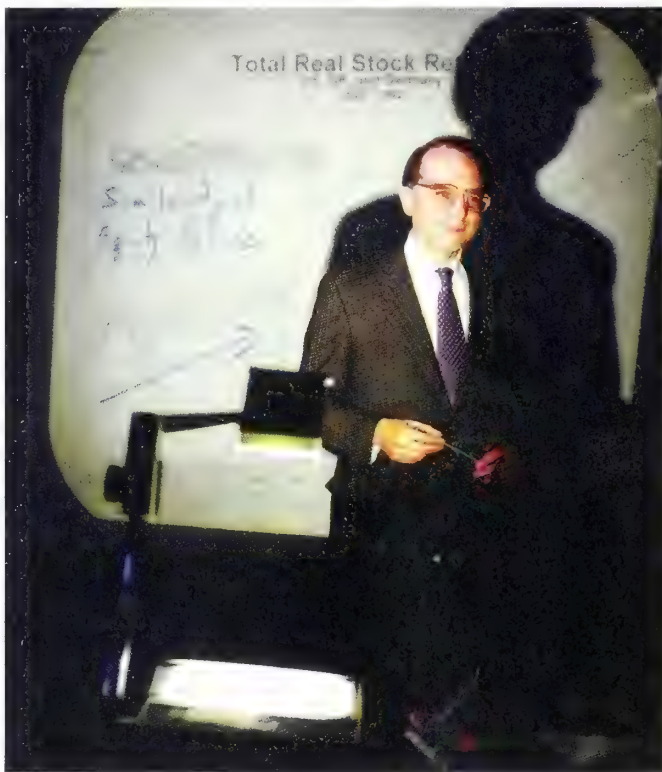
From the moment Jeremy J. Siegel shuffled to the front of the classroom at Highland Park High School in Illinois at the age of 14, he knew he was destined to become a teacher. Then, as a skinny sophomore with thick glasses, Siegel drew the undivided attention of the students with—of all things—a passionate speech on the Crash of 1929. “My goal was to get up there and not freeze,” remembers Siegel, an economics professor at the University of Pennsylvania’s Wharton School. “It went exceedingly well, and I began to explain things to people.”

People apparently love to have Siegel, now 48, explain things to them. The wiry and energetic professor’s excellence in teaching has made him a Wharton institution. *BUSINESS WEEK* asked the members of the Class of 1994 at 44 prominent schools to name the most effective teachers they had had, no professor scored higher approval than Siegel. *BUSINESS WEEK*’s list of the top dozen business educators was culled from surveys of 4,608 graduates. Wharton was asked to name their two best teachers. The school, with the highest percentage of votes, adjusted by school size, made the list (table, page 74).

POINTS AND STICKS. These top teachers are a varied lot. They boast stellar reputations that extend far beyond the classroom, including Michigan’s C. K. Prahalad, whose co-authored essay on core competencies is the *Harvard Business Review*’s most reprinted article, and Siegel, whose trenchant analysis of the stock and bond markets has made him among the most quoted B-school economists. Not surprisingly, the top teachers teach finance, the mainstay of business education, and have tenure—with the exception of 34-year-old Steven Kaplan of the University of Chicago.

For these masters of the classroom, recent efforts by many schools to nurture and reward good teaching are vindication of academic careers focused on the transfer of knowledge to students rather than the publication of esoteric research in scholarly journals. For years, they have seen mediocre teaching win promotions and tenure only because they were professors. With a handful of exceptions such as Harvard, Dartmouth, and Virginia, most B-schools clearly put more value on scholarly research than teaching ability. But that’s slowly changing. Deans are using a variety of carrots

and sticks to improve classroom performance. They are handing out bigger merit increases for teach-



At 14, after giving a speech about the Crash, “I began to love explaining things to people.”

—JEREMY SIEGEL, University of Pennsylvania

ing and weeding out lackluster nontenured professors. At New York University’s Leonard N. Stern School of Business, a new associate dean is creating detailed teaching “portfolios” to be used for all tenure decisions. The University of Rochester’s William E. Simon Graduate School of Business has launched systematic peer reviews that lead to formal written evaluations for all instructors. And at Columbia University, the dean kept one poorly performing teacher with tenure out of the classroom for two full years until coaxing him into early retirement.

The top profs applaud such efforts. But they also maintain that leading-edge research is vital to superior teaching. “The stock value of teaching is going up, but at the same time you don’t want to diminish the research because that is the raw stuff we work from,” says John A. Boquist, a much admired finance professor at Indiana University’s B-school.

While some of them do little ground-



“I need the fix of talking in front of a group of people about something I enjoy.”

—ASWATH DAMODARAN,
New York University

breaking research, most are hardly slouches when it comes to research and publication. Chicago's Kaplan is an associate editor of four scholarly journals and author of 20 published articles on corporate governance and leveraged buyouts. Robert F. Bruner, a professor at the University of Virginia's Darden School, is author, co-author, or supervisor of

Cover Story

THE BEST B-SCHOOLS

161 case studies and technical notes. Columbia's Bruce C. N. Greenwald, who earned a 6.9 student rating on a 1-to-7 scale in microeconomics, has published nearly 30 academic articles. Northwestern University marketing dynamo Louis W. Stern has consulted for the likes of IBM, Ford, AT&T, Eastman Kodak, and General Electric.

NAMES AND FACES. What really sets these professors apart is their enthusiasm for teaching and their genuine interest in their students. "If you don't show enthusiasm and life, it would be perfectly all right for the students to put their heads on their desks and go to sleep," says Stern. Aswath Damodaran, the boyish-looking finance maven at New York University, has gotten so wrapped up in his teaching that he has fallen off the raised platform at the front of his class several times. A self-described teaching addict, he became the youngest winner of the university-wide Great Teacher Award in 1990 at the age of 33. "I need the fix of talking in front of a group of people about something I enjoy," says Damodaran.

All of these teachers also spend many hours preparing for their classes—and expect students to do the same. Says Sharon Oster, the top-rated professor at Yale University's School of Organization & Management: "I've never been one to wing it in the classroom." Chicago MBAs walking into Kaplan's class are often startled when he greets them by name: The professor memorizes the names and pictures of all his students before the first day of class. "It tells them I'm taking this seriously and they ought to as well," says Kaplan. Bruner

"You don't want to diminish the research because that is the raw stuff we work from."

—JOHN BOQUIST, Indiana University



Masters of the Classroom

MBAs single out these professors as the best teachers in the world of business.

PROFESSOR	BUSINESS SCHOOL	EXPERTISE
MICHAEL BARCLAY	Rochester (Simon)	Finance
RANDOLPH BEATTY	Southern Methodist (Cox)	Accounting
JOHN BOQUIST	Indiana	Finance
ROBERT BRUNER	Virginia (Darden)	Finance
ASWATH DAMODARAN	New York (Stern)	Finance
BRUCE GREENWALD	Columbia	Finance/ Economics
ANDRE PEROLD	Harvard	Finance
STEVEN KAPLAN	Chicago	Finance
GERALD LYNCH	Purdue (Krannert)	Economics
C.K. PRAHALAD	Michigan	Strategy
JEREMY SIEGEL	Pennsylvania (Wharton)	Finance
LOUIS STERN	Northwestern (Kellogg)	Marketing

DATA: BUSINESS WEEK SURVEY OF GRADUATES

regularly invites MBAs to his home for dinner, and Siegel expects to hold a dozen luncheons with students this year. Randolph P. Beatty of Southern Methodist University is known for the copious comments he often jots in the margins of student papers.

Many of these teachers say they strive to blend theory and real-life examples in class. The professors say if they can show MBAs why the theory is important, they'll listen. If you're trying to teach someone how to hit a baseball, you can talk about the theory of hitting a baseball, but they're never going to learn how to hit one until they get into a batting cage and take cuts," says Gerald Lynch of Purdue University. **SCUBA DUBA.** A good many also have a fair bit of the actor in them. They're provocative, challenging, and witty in the classroom, peppering lectures with jokes, anecdotes, and highly personal, sometimes embarrassing stories about themselves.

Stern tells classes that he once ruined the quarterly profits of an entire division of retailer Filene's because of the way he took markdowns as a student intern there. "It's sort of like performing: When you do something, you see the students' eyes light up, and that's really exhilarating," says Kaplan. Indiana's Boquist once took the acting analogy literally: For a case study on a company making diving equipment, he filmed his own instructional video. Clad in scuba gear and wading in a swimming pool, he led students through the case's fundamental points on cash flows via videotape.

Goofy? Sure. But it's a lesson not likely to be forgotten by his students. Like Siegel, these are teachers who know how to make financial arcana compelling—ranging from ages 14 and up.

By Lori Bongiorno in New York

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GLOBAL EXCELLENCE

THE STARBUCKS ENTERPRISE SHIFTS INTO WARP SPEED

Despite signs of a slowdown, the gourmet coffee chain plans to open 200 more stores



Before Starbucks Corp. opened its first Manhattan store last March, the Seattle-based chain of trendy coffee bars carefully studied customers at local coffee shops. New Yorkers, it concluded, preferred drip coffee to the exotic espresso-based drinks that have made Starbucks famous. So, when the company designed its store on Manhattan's Upper West Side, it provided extra drip coffee makers and cut back espresso machines. But opening day was a surprise: Drip coffee went virtually untouched, while lines for espresso snaked out the door.

When you're opening 150 stores a year in new markets across the U.S., you have to expect glitches. Yet so far,

Starbucks' rapid rollout has been nearly trouble-free. From nine Seattle stores in 1987, Chief Executive Howard Schultz exported Starbucks' chic cafés around the West Coast, and last spring, to New York, Boston, and Minneapolis. This fall, Starbucks moves into Atlanta,

To keep its image fresh, Starbucks has its own in-house designers and architects

Dallas, and Houston. Almost two million Americans hit Starbucks weekly for skinny lattes and no-whip mochas.

Now, with 425 stores in place, Schultz has bigger plans brewing. Over the next year, Starbucks will open 200 new stores and move into Philadelphia and Las Vegas. At the same time, Starbucks has announced plans to expand abroad. Next year, it will launch a new bottled coffee drink.

But it is entering new terrain as the company has hit a snag. A slowdown in sales at stores open a year or more has brought its sky-high stock price—Starbucks recently traded at 10 times estimated 1994 earnings—back to earth. With rivalry increasing and coffee prices up, even longtime bulls at Starbucks is taking on too much. "They've shown they can open up stores but to open in so many regions at once requires a whole different level of organizational growth," says analyst John Michel Valette of Hambrecht & Quisenberry Inc. "With such a high-multiple stock price, you can't afford any uncertainty."

CEO SCHULTZ: Schultz's reputation has worked well so far. In November, Starbucks should announce earnings of about \$13 million for the fiscal year ended

Oct. 2, up 53% from 1993's \$8.5 million. Sales of \$285 million were up 74% from 1993's \$163.5 million. By 2000, Schultz wants to quadruple sales to \$1 billion.

But success has brought a host of competitors. Fort Lauderdale-based Brothers Gourmet Products Inc. is opening an 80-store chain of Brothers coffee bars, while Seattle's Best Coffee plans to franchise nearly 500 stores nationwide within the next five years. And as mid-range and pop espresso stands pop up on every corner, big players such as Dunkin' Donuts are improving their coffee offerings. Analysts expect Starbucks' operating margin, now at 7.8%, to suffer. "The returns are not going to be as great as in the past," says analyst John

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Canon

B. Rogers of Jensen Securities Co. in Portland.

Yet if Starbucks' rapid expansion is fraught with risks, even competitors say it's a model of a small company preparing well for growth. Many small entrepreneurial companies stumble as sales explode, but Schultz has stocked Starbucks with experienced managers from bigger chains and invested heavily in its personnel, information systems, and facilities. "If we are going to build a 100-story skyscraper, we have to build a foundation strong enough to sustain 100 stories," says Schultz. "I believe in the adage: Hire people smarter than you are and get out of their way." Adds Starbucks board member Craig Foley, a venture capitalist with the Dallas-based Phillips-Smith Specialty Retail Group who has worked with hundreds of small companies: "What's unusual about Starbucks is that it has a founder able to grow with the company."

While Schultz wasn't Starbucks' true founder—it began in 1971 as a gourmet coffee bean store—he built it up after buying it with local investors in 1987 for \$3.8 million. Inspired by a trip to Italy, Schultz began opening stylish coffee bars serving espresso drinks.

Rivalry is growing, coffee prices are higher. Is Starbucks taking on too much?

At first, Starbucks lost money as Schultz spent heavily to prepare for expansion. Most important was management. By 1990, he had hired two key executives: Howard Behar, former president of outdoor resort developer Thousand Trails Inc., and Orin Smith, from freight forwarder Danzas Corp. They decided to focus on high-end gourmet coffees. To maintain quality, Starbucks roasts all its coffee in-house. It also turned down lucrative alternatives such as franchising and supermarket distribution. All stores are company-owned.

Schultz also filled his middle ranks with experienced managers from companies such as Taco Bell, Wendy's, and Blockbuster. One regional vice-president ran 2,500 Burger Kings before joining Starbucks. "That's what's given us

the base to grow," says Smith, who became president in June. Equally critical are the Starbucks "baristas" who prepare its coffee drinks. Rather than the high schoolers and immigrants usually hired by fast-food chains, Starbucks finds its recruits in colleges and community groups and gives them 24-hour training in coffeemaking and lore—helping to create the hip image and quality service that build customer loyalty.

MOUNDS OF DATA. Behind-the-scenes operations are also typical of retailers many times Starbucks' size. Invested heavily in a computer network to run his expanding empire, Schultz hired top information-technology specialists from McDonald's Corp. to design an advanced point-of-sale system that allows managers to carefully track sales. Each night, store PCs pass information to Seattle headquarters, so planners quickly spot regional buying trends.

To keep its image fresh and fashionable, Starbucks has designers and architects in-house. At headquarters, designers examine palettes of soft-colored leather and test the angle of banquettes and backs. Site selection is also key. The real estate division begins work up to 18 months before a store opening, sifting



The Theatre.



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e language. We
set baristas four
off the ground,"
Brothers' CEO, Den-

oyer. "Starbucks is more of a cult."
rbucks is now seeing its first signs
wdown. Although sales from ex-
stores grew 20% annually in the
they rose just 9% in fiscal 1994.
r coffee prices also hurt sales. Al-
h overall revenues were still up
he slowdown worried many inves-
Since June, Starbucks' stock has
ed from 32½ to 25¼.

BREW. But Schultz argues that in
rket far from saturation, slow
h in established stores is no worry.
rkets such as New York, sales at
tores are hitting capacity quick-
nd in popular locations, Starbucks

STARBUCKS' POTENT BREW



purposely opens stores near old ones to cut lines. Portfolio manager Brooke de Boutray of Seattle-based Zevenbergen Capital, which owns just under 1% of Starbucks, agrees—and says the stock drop is a buying opportunity. "Starbucks has the financial flexibility and management strength to handle growth," she says. "We see them becoming the McDonald's of the gourmet coffee business."

Other risks lie ahead, though. In June, Starbucks made its first acquisition, buying The Coffee Connection Inc., a 23-store Boston rival, for about \$23 million. Although the move gives Starbucks a new market without a fight, integrat-

ing the chain may be difficult. And in 1995, Starbucks plans to team up with foreign partners to open stores in Europe and Asia. But the Starbucks chic may not appeal overseas.

Most risky is a venture with PepsiCo, announced in August, to develop a bottled coffee drink under Starbucks' name and distributed through Pepsi's network. That worked for Pepsi's venture with Lipton Tea Co., winning

the No. 1 spot in supermarkets for ready-made iced tea. But many Americans don't drink cold coffee, and a cold cappuccino drink, Cappio, from General Foods Cos., flopped in the U.S.

Such risks are just another challenge for a man who has already changed America's coffee-drinking habits. "It tastes wonderful," Schultz says of the new drink. "We wouldn't develop it if we thought it would taint our brand equity." If Schultz has his way, customers will soon be clamoring for Starbucks iced coffee the way they line up for mochas in Manhattan.

By Dori Jones Yang in Seattle



The Director.

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IF YOU CAN'T BEAT 'EM, BUY 'EM

Steelworkers-owned plants offer half union pay but 25% equity

For years, the United Steelworkers (USW) has watched helplessly as nonunion minimills have grabbed market share and jobs from major steelmakers. The union tried to organize the upstarts but had little luck. Now, it's tackling them on their own turf.

In late September, the USW formed what amounts to a joint venture with a New York investment group to buy two high-cost plants that Bethlehem Steel Corp. shut down in 1992. The union agreed to flexible work rules and minimill-like pay scales that are only half what union members make at integrated mills. In return, workers at the new company, called BRW Steel Corp., get a 25% equity stake and two seats on the

board of directors—plus 800 jobs (table).

The new approach is a big gamble for the union. If it works, the USW may have a model for fighting off minimills. The union may even be able to use BRW as an organizing tool by showing minimill workers that unionization could bring them an equity stake. However, because BRW will compete against big steelmakers, it gives them an opening to demand similar pay and work rules.

ROCKY ROAD. The BRW pact didn't come easily. In 1992, the union angered many people when it nixed a deal set up by Pennsylvania Governor Robert P. Casey, a longtime union ally. He had found an Indonesian company, Ispat Group, that was willing to invest \$100



VICTORY: Veritas partner Tom Campbell and family party with the USW

million in the Bethlehem plants, the largest of which is in Johnstown. But the union opposed Ispat's terms, which were similar to BRW's but without the equity. It drove Ispat off without even letting unemployed Bethlehem workers vote on its offer. Some Johnstown residents were angry and some even torched the union hall.

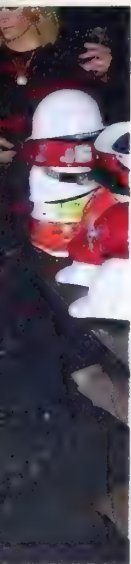
Within months, however, the union



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CAN THE STEELWORKERS TAKE ON THE MINIMILLS?

The United Steelworkers has agreed to a minimill-like contract to help revive two plants at a former Bethlehem Steel division, now called BRW Steel Corp.

	BETHLEHEM STEEL	BRW STEEL
NUMBER OF EMPLOYEES	2,250	800 by 1997
ANNUAL OUTPUT	700,000 tons	500,000 tons
NUMBER OF JOB TYPES	30	5
PAY AND BENEFITS	\$24/hour	\$16/hour, plus 25% of equity

DATA: VERITAS CAPITAL INC., BETHLEHEM STEEL CORP.
UNITED STEELWORKERS

ed a tentative agreement with York-based Veritas Capital Inc. up BRW. The result is a company will have more in common with Corp. minimills than with Bethlehem Steel—or with smaller steel companies where the union has swapped divisions for equity. Instead of Bethlehem's 30 job categories, BRW will have five flexible groupings. Workers trained to do different jobs, as in minis, and will be encouraged to do whatever problems come up. And

itive with rivals in the bar-and-wire products it will make, mostly for the auto industry. What's more, Veritas got the plants, which cost Bethlehem some \$500 million, for \$25 million. And Pennsylvania and New York are chipping in \$51.5 million worth of low-interest loans to modernize them.

BRW's handicap is the 230-mile shuttle from Johnstown to its finishing mill in Lackawanna, N. Y. That adds \$14 per ton to costs. "They've got their work cut out for them," says James A. Todd,

pay starts at \$16 an hour, including benefits, much closer to base pay at minis than the \$32 average at integrated mills.

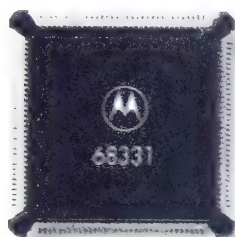
That spells less power for the union, which was a sacrifice leaders were unwilling to make for the Indonesian company. But if workers are shareholders, it doesn't look so bad. For starters, the pay and lean organization should make BRW compet-

chairman of minimill Birmingham Steel Corp. Still, Veritas President Bob McKeon says BRW will undercut its competitors by as much as 25%. "Their costs include massive corporate overhead," he says, plus "huge depreciation and amortization costs."

"LEAP OF FAITH." While former Bethlehem workers would welcome success at BRW, it would put more strain on the union's relations with major steelmakers. Last year, USW leaders signed far-reaching cooperative agreements with Big Steel that cut work rules and tie pay to production. Even so, steelmakers' costs remain higher than the minis. Union leaders say they're not worried about BRW undercutting the pact, because it won't be up and running for two years.

Still, the USW probably doesn't have much choice if it wants to stay competitive. Indeed, the union is already hammering out a similar deal with British investors at shuttered Sharon Steel Corp. in Farrell, Pa. The USW "had to make a leap of faith to embrace the work practices and cost structures of minimills," says Pennsylvania Commerce Secretary Andrew T. Greenberg. The union may be making similar leaps in the future.

By Keith L. Alexander and Stephen Baker in Johnstown, Pa.



Counter.

Magellan gets its incredible vision from the Motorola 68331 microcontroller, which translates graphic information into binary data for the main computer. From scanners to CD-i players, products powered by Motorola are fast becoming a way of life.



MOTOROLA

Microcontroller Technologies Group

YOU CAN'T KEEP A REICHMANN DOWN

Paul is scouting New York properties again—and may even be trying to buy back debt

They are easy to overlook—those small rectangular boxes at each of the elevators on the 12th floor of 237 Park Avenue. This is the U.S. headquarters of what once was the nation's mightiest power in commercial real estate—Olympia & York Developments Ltd. (O&Y). The little boxes, mezuzahs held sacred by devout Jews, contain passages from the Hebrew scriptures. When the Hungarian-born financier Paul Reichmann lost control of O&Y in 1992, after the failure of Canary Wharf in London touched off the O&Y empire's collapse, the mezuzahs stayed.

It was a sign of respect for the soft-spoken, deeply orthodox Reichmann. Loyalty to Reichmann has remained strong at O&Y, even as its executives wrestled with the firm's \$5 billion in debt, a messy melange of legal disputes, and a multinational herd of creditors so discontented that former Secretary of State Cyrus R. Vance was called in last year to mediate. The legal wrangle is as complex, and heated, as ever. But today the mezuzahs at 237 Park have become emblematic of the resiliency of the man who put them there. The world of New York real estate is abuzz: Paul Reichmann is back.

POWERFUL PARTNER. According to his friends and rivals in New York real estate, Reichmann has been scouting Manhattan office properties over the past few weeks. And although Reichmann, through a spokesman, denies it, there are persistent reports circulating in New York real estate circles that he has even made a thus-far fruitless effort to buy O&Y debt. That is not as far-fetched as it seems. Reichmann is believed to have patched up a quarrel with his new backer, the famed investor George Soros—a dispute that threatened to torpedo their year-old joint venture, the \$500 million Quantum Realty Trust offshore fund.

With Soros' money apparently still behind him, Reichmann cannot be counted out as a potential player in the restructuring of O&Y, despite the lega-

cy of Canary Wharf and financial troubles elsewhere, particularly in Canada. "A bad rap lasts a year or two, and then it's 'forgive and forget.' I would view Reichmann as a logical participant" in the O&Y restructuring, notes Peter Hauspurg, chairman of Eastern Consolidated Properties Inc., a New York commercial real estate firm. Paul Reichmann's quest to return to the scene of some of his greatest triumphs is but the latest chapter in New York's longest-running real estate drama: "Whither O&Y?"

The stakes are high. At issue is not just the O&Y U.S. holdings (chart), and the \$5 billion owed on them to an array of creditors from Citibank to Sanwa Bank Ltd. to an assortment of Cana-

dian and Hong Kong institutions. To a large extent, the fate of O&Y—still New York's largest office landlord—will determine whether the city's downtown real estate will continue to languish or finally revive.

So long as O&Y remains in a twilight zone, the same will be true for the rest of lower Manhattan, which is already overburdened with a host of antiquated buildings. Tenants entering into long-term leases want to have some idea who their landlord will be—and that's anything but certain for the O&Y buildings. "It's difficult to do a deal when the ownership of a property is in doubt," notes Nathan Aber, a former top O&Y official who is president of AmTrust Realty, a New York firm that has been by



ONE LIBERTY PLAZA



O&Y HEADQUARTERS

O&Y's Main U.S. Holdings

Property & Rentable Space
(square feet)

WORLD FINANCIAL CENTER

6.0 million

ONE LIBERTY PLAZA

2.13 million

1290 AVE. OF THE AMERICAS

2.0 million

245 PARK AVE.

1.62 million

2 BROADWAY

1.58 million

125 BROAD ST.

1.36 million

237 PARK AVE.

1.14 million

60 BROAD ST.

1.01 million

425 LEXINGTON AVE.

0.7 million

DATA: OLYMPIA & YORK



WORLD FINANCIAL CENTER

office buildings in
Manhattan.

legal dispute over
complex, but basic-
bills down to a conflict
en New York and Ca-
creditors and equity
s. And so far, the two
have been unable to
how to restructure
ot and equity under-
O&Y's U.S. holdings,
the World Financial
in lower Manhattan.
80% of the equity is
lled by Canadian and
Kong banks, includ-

Canadian Imperial Bank of Com-
and Hongkong & Shanghai Bank-
orp. Meanwhile, the unsecured
largely owned by American cred-
including Citibank and "vulture"
or Leon Black's Apollo Real Es-
investments.

IS IT WORTH? Will the Canadian
holders get anything? Not if the
can creditors have anything to
out it. The U.S. side of the dispute
ins that the Canadians' equity is
ially worthless. (Canadian Impe-
nk of Commerce and Royal Cana-
ank declined to comment.) Com-
ing the picture is that O&Y's
o-based parent company has gone
h bankruptcy, while the U.S. firm
en trying to restructure its debt



COMEBACK With Soros' money behind him, Paul Reichmann could play a role in O&Y's restructuring

without undergoing formal bankruptcy proceedings. The wrath of the U.S. financiers is directed mainly at the administrator of the Canadian parent, Robert E. Lowe, a partner at Coopers & Lybrand in Toronto. Lowe has sought to discharge two members of the board of the U.S. company, Chairman Richard Shinn and Willard C. Butcher, former chairman of Chase Manhattan Corp. The move was viewed by the U.S. side as a power play by Lowe, whom they describe as acting mainly to defend Canadian interests. Lowe declined to discuss the reasons for the effort to discharge Shinn and Butcher or to otherwise comment on the dispute.

The parties are, for the moment, trying to iron out their differences. A hear-

ing on the firings was set for Nov. 2 before Judge James L. Garrity Jr. of the U.S. Bankruptcy Court for the Southern District of New York. However, in recent days the various sides, prodded by Garrity, have agreed to a 60-day moratorium on court action. That will keep Shinn and Butcher on the board—and it also will put off another possibility that has been feared, that O&Y in the U.S. will be forced into bankruptcy by discon-

tented creditors. But that scenario is discounted, at least by the U.S. creditors. And it appears that the wrangling is finally coming to a conclusion. "You are getting into the endgame. The question is how it plays out," says Martin Turchin, vice-chairman of Edward S. Gordon, a New York-based real estate brokerage.

THE FATES. So how will it play out? One possibility is that the O&Y buildings might be turned into a public investment vehicle—a real estate investment trust (REIT) or a partnership. But the market for REIT offerings has been crummy, particularly for the smattering of office REITs that have come to market recently. "If there are unique office properties priced uniquely low, they may have a chance of coming to market," says Robert Steers, president of Cohen & Steers, a \$1.1 billion real estate fund that is the largest U.S. investor in real estate equities.

The problem, of course, is that a "uniquely low" price would defeat the purpose of an O&Y REIT, at least from O&Y's standpoint. Steers notes that one newly minted office building REIT, New Jersey-based Cali Realty Corp., has declined by over 20% since it went public in August. That does not bode well for similar REITs being given handsome valuations by the market. Likewise, Steers believes a real estate partnership would not get a very enthusiastic reception in the "sloppy underwriting environment" nowadays.

The wild card in all this is Paul Reichmann. Even executives who have fled O&Y—it has lost many key people in recent months—agree that Reichmann is an uncommonly brilliant man. And as his deal with Soros indicates, he is itching to get back in the game. "I saw Paul the other day, and he had that old twinkle in his eye," says one Reichmann friend. Perhaps he is waxing nostalgic for the good old days. Or maybe he knows something we don't know.

By Gary Weiss, with Suzanne Woolley, in New York





INVESTMENT MANAGEMENT

TO BE YOUNG, GIFTED, AND SITTING PRETTY

Buddy Fletcher's trek from Kidder to his own lucrative firm

Though he is only 28, Alphonse "Buddy" Fletcher Jr. has already achieved an unusual amount of notoriety on Wall Street. He is the black trader who sued Kidder, Peabody & Co. for stiffing him on his bonus and won a \$1.3 million award in 1992. He also sued Kidder for race discrimination. That case went all the way to the Supreme Court, which refused to hear it, landing it back in arbitration, where it is still pending.

Yet Fletcher is an atypical figure in less widely known ways. He owns and runs his own successful, 11-person investment management firm in New York, Fletcher Asset Management. Audited financial statements say he has racked up triple-digit annual returns. "He's a huge success and a good guy," says Alan C. Greenberg, chairman of Bear, Stearns & Co., another of Fletcher's former employers.

Fletcher, who was educated at Harvard University, doesn't disguise his wealth. He gets around town in a chauff-

feured Jaguar, lives in one of Manhattan's most prestigious buildings, the Dakota, and has elegant offices in midtown Manhattan, complete with a private chef and stunning views of Central Park. To Fletcher, luxury is a necessity for his fledgling firm. "When we call a company and say we'd like to invest millions of dollars when other investors are shying away, sometimes they don't take us seriously," he says.

While thriving in the white world of Wall Street, Fletcher—as his discrimination action against Kidder suggests—has declined to simply assimilate quietly. In 1993, he pledged \$1 million to a National Association for the Advancement of Colored People

SMART MOVE: Fletcher made a killing buying Zenith at its nadir

endowment for the Reginald F. Lewis fund, named for a black businessman who befriended Fletcher. "Buddy is not looking for any special edge because he is black, nor has he forgotten he is black," says Steven Rattner, an investment banker at Lazard Frères & Co. and a former neighbor of Fletcher's. "He has found a way to deal with it."

Fletcher has achieved impressive investment results by pursuing niche plays ignored by others on Wall Street. An applied-math major at Harvard, he started out as a quantitative equity trader doing dividend-related arbitrage. Popular in the late 1980s, the strategy involves buying stock from companies at a discount to market price, often under corporate dividend reinvestment plans, and selling it soon after at the market price. "He's very smart and creative. He's looking at new ways of doing things," says J. Pedro Reinhart, treasurer of Dow Chemical Co., a Fletcher advisory client.

DIVE-PROOFING. Fletcher's latest niche is buying equity stakes directly from companies, ideally at a discount to the market price. He chooses companies that are strapped for cash but have fundamentally sound underlying businesses and could turn around within a year. While that strategy is common, Fletcher's approach uses a sophisticated hedge of his own design—employing different options and offsetting stock positions—to minimize the damage if the stock takes a dive and yet profit if the stock goes up. Says Fletcher: "If the hedge works, and you can tie up a very, very small amount of capital in the process, even if the stock declines, we should be O.K. And if it runs, we win big."

His biggest killing so far dates to 1992, when he bought Zenith Electronics Corp. He got interested in buying the company after reading newspaper reports in 1992 about the company's liquidity crisis. Further, the company was about to issue 5 million shares of stock. Zenith executives initially ignored Fletcher's request to buy a big stake. But Rattner, whose firm was representing Zenith, changed their minds. Fletcher bought 2.25 million shares, or 7% of Zenith, at about \$6.85 a share.

Alphonse Fletcher

AGE
28

EDUCATION

BA, Harvard College, applied-math major

PREVIOUS EMPLOYERS

Bear Stearns, Kidder Peabody

CURRENT POSITION

Founder and CEO, Fletcher Asset Management

INVESTMENTS

Zenith Electronics (7%),
Compression Labs (5.6%),
Cytogen (2%)

CONTRIBUTOR

NAACP, United Negro College Fund, Harvard

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Edward E. Whitacre, Chairman and CEO



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*Total Shareholder Return as measured from 1984 to 1994. Source: Standard & Poor's Compustat.

\$15 million in two separate blocks. The stock is now trading at 12. Since Fletcher paid Zenith with mostly borrowed money, his return was magnified by leverage. Says Kell B. Benson, Zenith's chief financial officer: "I'm quite impressed with him and his people."

Fletcher has negotiated investments in two other companies, Cytogen Corp., a Princeton (N.J.) biotech concern, and Compression Labs Inc., a videoconferencing company. But he's still waiting for the payoff: Their stocks haven't budged much from where he bought them.

Yet overall, Fletcher Capital Markets, his trading vehicle and a broker-dealer, claims stellar results. A report by certified public accountants Goldstein Golub Kessler & Co. says Fletcher had returns of 471% in 1992 and 177% in 1993, and unaudited returns of 267% in 1994 through Aug. 31. While Fletcher won't disclose how much he is managing, a Securities & Exchange Commission filing said Fletcher Capital had \$46 million in assets and \$3.6 million in equity at the end of 1993.

Fletcher gives his family and Harvard credit for his success. He and his two younger brothers, also Harvard grads, were raised in a middle-class home in Waterford, Conn. Fletcher was class marshal, or president, of his 1987 class at Harvard.

BONUS BRAWL. He got his start on Wall Street when Bear Stearns recruited him in 1987 to work in the options department. In 1989, he jumped to Kidder to be a vice-president in its equity department. He parted ways with the firm in 1991 following the dispute over his bonus. He says Kidder paid him \$1.7 million instead of the \$3.9 million he says the firm had promised him. He set up his own firm in March, 1991. A few weeks later, Michael S. Meade, a former Kidder trader, Harvard pal, and currently his only partner, joined him.

Fletcher has made hiring mistakes along the way. He initially staffed up to 22 people before trimming down by half. He is also in arbitration against a former employee he claims stole proprietary ideas.

Fletcher's next step could be raising money from outside investors. Possibly in preparation, this October he withdrew his broker-dealer registration and became a registered investment adviser, a vehicle more convenient for managing money. If he can keep producing outsized returns, he could win a more desirable kind of notoriety—as an investor instead of a plaintiff.

By Leah Nathans Spiro in New York

COMMENTARY

By Patricia Kranz and Joan Warner

RUSSIA'S BLACK TUESDAY: THE BLOOD OF A FREE MARKET

Rumors of the Russian economy's imminent collapse into chaos have been greatly exaggerated.

When the ruble lost 27% of its value against the dollar in one day, traders were quick to call it Black Tuesday. The panic began when central bank officials decided they would stop supporting the declining ruble and let it reflect the rising money supply. Currency traders, scared by the lack of accustomed intervention and already worried about a possible resurgence of inflation, started a selling frenzy. The rout stopped only when the central bank stepped in. On Oct. 12, the ruble rebounded 4.8%, closing at 3,736 (chart).

Russian President Boris N. Yeltsin sacked Finance Minister Sergei Dubinin and demanded that lawmakers dismiss central bank Chairman Viktor Gerashchenko. But while the strong show of leadership may have helped soothe the market, Yeltsin is aware that the central bank isn't completely to blame. "The main reason for the crisis is the adoption of an unrealistic budget for 1994," says Grigory Yavlinsky, who heads a reform-minded parliamentary faction. Had the government not spent 13 trillion rubles on subsidies this year to farmers, the defense industry, and other groups, the bank wouldn't have had to support the ruble artificially. Just as in any other country, Russia's financial markets respond principally to the threat of inflation—or its absence.

Indeed, what happened in Russia on Black Tuesday is not unlike what happens to a Western bond market when a growth forecast is revised upward or a central banker makes dovish remarks. The difference is that Russia's market is still crude and lawless. No automatic mechanisms halt trading when a stock, bond, or currency goes into free fall. There are no limits to how much

speculators can buy or sell. "Basically, there's a total lack of financial infrastructure," says Ronald Lauder, chairman of Estée Lauder International, who opened one of the first Western stores in Moscow in 1989. "You're missing the laws, the checks and balances, that in other economies prevent such excesses."

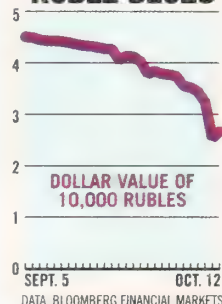
The ruble rout caused significant hardship on Black Tuesday. Consumers bought all the supplies they could carry, to hedge against price increases. Merchants sharply marked up prices on both Russian and imported goods. A liter of milk that had cost 670 rubles on Friday fetched 1,100 rubles four days later, while a Snickers bar rose to 1,500, from

1,000. Some retailers took big hits because they could not exchange their ruble revenues as fast as the rate dropped. Since all cash transactions must be done in rubles, only merchants that can accept credit cards were safe.

AMBITIOUS PLANS. But despite the carnage and Yeltsin's Cabinet shuffling, officials at the International Finance Corp., which has invested \$10 million in Russia, said the current crisis wouldn't undermine the trust of Western investors. Lauder believes such episodes are inevitable in an immature market, and his confidence in Russia is unshaken.

Yeltsin can show he is serious about controlling inflation by forcing his government to slash expenditures. Early hints of the 1995 budget proposal are ambitious, with an average monthly inflation target of 2%. Like leaders all over the world, Yeltsin must walk the fine line between stimulating his economy and keeping prices from spiraling. Black Tuesday, though painful, was a reminder that the laws of economics apply fully in Russia. Now, the country must learn financial damage control.

RUBLE BLUES



DATA: BLOOMBERG FINANCIAL MARKETS

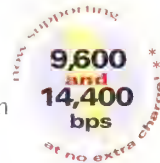
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BY GENE G. MARCIAL

LAZER-TRON MAY BE A WINNING TICKET

If there's anybody who knows coin-operated gaming machines, it's Chuck Mathewson, chairman of International Game Technology, who steered that company's sales from \$83 million in 1987 to about \$600 million this year. So when Mathewson buys into another similar company, money pros pay heed.

Lately, Mathewson has acquired 5% of little-known Lazer-Tron, which makes the ticket-redemption games played by young people in arcades, bowling alleys, and theme parks. Such games reward players with tickets that can be redeemed for prizes or merchandise, such as T-shirts and radios.

Mathewson, who bought the stock, now at 9¢ a share, for his personal portfolio—"for my kids and family"—says he's impressed with Lazer-Tron products. "And with the company's good management team, clean balance sheet—and it's making money fast—what more can you ask?" he says.

Stuart Ruddick, president of Ruddick Asset Management in Mill Valley, Calif., is also buying. "When I see smart people such as Mathewson buy

ness," says Ruddick. But people in the industry sure know about it. One money manager says both International Game Technology and Sega tried—and failed—to acquire Lazer-Tron before it went public.

Lazer-Tron's sales and earnings are soaring: Both have more than doubled in each of the past three years. For the year ended June 30, 1994, revenues jumped 114%, and profits soared 136%—from 25¢ a share to 59¢. Ruddick figures earnings will hit 75¢ in fiscal 1995 on sales of \$24 million. Sales in fiscal 1994 were \$15.4 million.

He notes that the popularity of ticket-redemption games has resulted in the huge growth of family entertainment centers, which usually feature a miniature-golf course, a go-cart track, and an arcade and amusement center. Lazer-Tron was the first to combine digital sound effects and other uses of high technology to provide more interaction with the player, explains Ruddick. Recently, the company introduced new redemption games, including the Flintstones Bedrock Games, Pogger, and Pirate's Gold.

A BEELINE FOR SPELLING?

After acquiring Blockbuster Entertainment, Viacom Chairman Sumner Redstone has one piece of unfinished business to deal with: Spelling Entertainment, a film producer and distributor 78% owned by Blockbuster.

The betting is that with Blockbuster now a part of Viacom, the latter will opt to buy the 22% of Spelling that it does not already hold. If it does, Viacom would gain control of Spelling's cash flow and would no longer have to pay dividends, says Paul Marsh, analyst at NatWest Securities. And by absorbing Spelling, Viacom would save at least \$10 million in annual overhead expenses, he estimates.

Spelling's assets, such as Virgin Interactive Entertainment, a maker of interactive entertainment software, would blend well with the Viacom-Paramount-Blockbuster triumvirate, argues Marsh. And Spelling's TV library and production facilities could be coordinated with Paramount's, particularly

since Viacom is trying to create a fifth network, adds Marsh. Spelling's TV library includes such hit series as *Beverly Hills 90210*, *Melrose Place*, and *Burke's Law*. Spelling also owns Republic Pictures, so it has a rich library of movie films.

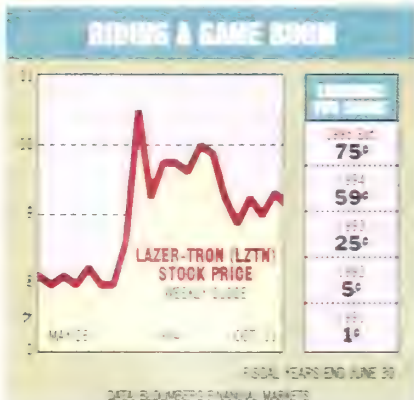
If Viacom delays buying Spelling the price of its stock, which has gone from 8 in July to 11 now, could well climb some more, making Spelling more expensive proposition. Marsh thinks Spelling is worth 15 to 17, but other pros figure it's worth 20 to 25.

GOOD LAB REPORT ON BIO-REFERENCE

The \$32 billion medical-testing business is hot—dominated by such giants as Corning's MedPath, National Health Laboratories, and SmithKline Beecham. So why are some money managers looking to buy into small regional labs? "Regional labs are where the national labs are looking for buyouts to sustain their fast growth," says one Boston fund manager. He has been acquiring shares of Bio-Reference Laboratories, probably the largest independent clinical lab serving New York, New Jersey, and Connecticut. Its stock, trading on the NASDAQ small-cap market at 5 is up from 3½ in early June.

Bio-Reference only recently announced an agreement to acquire privately owned GenCare Biomedical Research, whose labs provide DNA gene-probe technology, flow cytometry (used in identifying white cells), and tumor markers for diagnosing cancer. Bio-Reference itself does sophisticated tests for doctors and clinics, in addition to tests in fields such as clinical chemistry and diagnostic immunology. GenCare acquisition will help Bio-Reference provide "highly specialized cancer tests for oncologists and hospital pathologists," says Bio-Reference President and CEO Dr. Marc Grodman.

As a lab that has turned profitable this year, and in a region of the country with high-volume business, "Bio-Reference is an attractive target for takeover by some of the majors," says the Boston fund manager, who estimates the company will earn 17¢ a share this year on revenues of \$23 million and \$30 million next year on sales of \$30 million. Last year, the company was in the red on sales of \$10 million. Based on recent takeovers in the industry, this pro believes the stock is worth 8 to 10.



heavily into a stock, I do the same," he says. Ruddick notes that San Francisco's BKP Partners has acquired 10% of Lazer-Tron. Another San Francisco investment firm, Van Kasper Advisers, which underwrote Lazer-Tron's initial public offering at 8 a share on May 26, holds 7%.

"Lazer-Tron may be one of the best-kept secrets on Wall Street, even though it's the leader in the rapidly growing ticket-redemption game busi-



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FROM THE MAN WHO BROUGHT YOU SILICON GRAPHICS...

Can Jim Clark score again with user-friendly Internet software?

James H. Clark has always been full of crazy ideas. As an assistant professor at Stanford University in 1981, he dreamed of making hyperrealistic 3-D graphics come alive on desktop computers. When every computer company he approached said there would be no market for such gear, Clark started Silicon Graphics Inc., now a \$1.5 billion company and about the hottest computer maker around. Its flashy workstations helped bring dinosaurs to life in *Jurassic Park*, and its technology is poised to play a key role in new multimedia services such as interactive TV.

So it's no surprise that few people are calling Clark's latest idea crazy—even if it is wildly ambitious. Today, Clark is out to tame cyberspace. By putting a user-friendly face on the Internet, his Mosaic Communications Corp. plans to open a huge market—the same way Apple Computer Inc.'s Macintosh and Microsoft Corp.'s Windows have made personal computers usable by the masses.

An estimated 20 million people now use the Net's 3.2 million computers, but tapping the system's vast resources can still require arcane commands—and a lot of patience. With the right software hiding that complexity and speeding delivery of high-quality graphics, video, and sound, Clark figures, the Net is sure to evolve into the Information Superhighway itself. "It's the country road system in the early days of the automobile," he says.

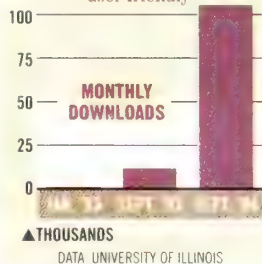
SURF'S UP. Clark thinks he can be its Henry Ford. His Model T: a program called Mosaic, created two years ago by students at the University of Illinois' National Center for Supercomputing Applications (NCSA). It lets people at desktop computers browse all kinds of multimedia documents stored in a part of the Internet called the World Wide Web, where people post electronic "pages" of



VISIONARY: Clark aims to create the Gutenberg press of cyberspace.

MOSAIC TAKES OFF

Mosaic, a program for desktop computers, makes the Internet user-friendly



of the NCSA's Mosaic, a "public-domain" package that can be downloaded free of charge. They're now grabbing more than 100,000 copies a month and passing on an unknowable number to friends (chart). With that kind of growth and broad impact, says Michael J. Walsh, president of market researcher Internet Info in Falls Church, Va., the Web "is as important as the development of television." It could make the Internet a

mass medium for home shopping, banking, and a host of other services.

The beauty of Mosaic and the Web is that they make surfing the Internet easy even for non-nerds. Just clicking at a mouse on a highlighted word or graphical button can whisk you effortlessly to computers halfway around the world. Today you can flip through a stash of colorful satellite photos, a download-shop at the Internet Mall, and relax at the Voodoo Lounge, an online trove of Rolling Stones concert photos, and sound clips. Tap into a Web computer at Clark's company and you can see a digital photo of what's going on in the fish tank there.

"Mosaic made the Internet come alive," says Clark. "Now, it's time to start a business." Clark, 50, invested \$3 million of his own money and lined up "several times that" from venture capitalists Kleiner Perkins Caufield & Byers. Last spring, he hired seven of the NCSA Mosaic developers, including 21

Wizard Marc Andreessen, to an all-new version of Mosaic. Mosaic NetScape, it's about to be shipped to consumers running Windows, Macintosh, and many versions of Unix. And by quickly displaying crude renditions of incoming pages and then fleshing them out with quality, the program works as fast as 10 times faster than the original Mosaic. Says one early user: "It's away."

Like SGI's early days, Clark faces immediate competition. At least 10 companies have bought licenses to commercialize Mosaic. SPRY Inc. in Seattle is already shipping its AIR Mosaic, a full-featured computer and software package, including IBM and Novell, are among competing Web browsers. Clark has big plans for outdoing these. He aims to get everyone from e-mailers and phone companies to makers of computers and software to use and sell his software. If his Web browser becomes the industry standard, it would open windows for PCs, Mosaic Communications could be the Gutenberg press of the Web. But with so many free copies, "We don't think Mosaic Communications will be able to set a standard," says Spyglass Marketing president Bob Rybicki.

AGGRESSIVE APPROACH. Clark has his own give-away program. This month he will start distributing NetScape for free across the Internet. The idea is to create demand for his more lucrative services that will work on Web servers. In November, those programs will cost \$5,000 to \$25,000 and will include such features as the ability to encrypt credit-card information secure. They will be marketed to companies setting up shop on the Internet.

Clark's aggressive approach to the market—other software makers accuse him of trying to convert public domain software into a proprietary standard—has enraged Clark. Even after SGI rocked to success, he kept fighting. Over objections by most executives, he pushed the company to sign high-profile deals to develop TV set-top boxes for Time Warner and game machines with Sega. That friction is one reason he quit. Quitting abruptly last winter, he passed up \$10 million in SGI stock. "He thinks he can do anything," says longtime SGI board member and venture capitalist C. Richard Kramlich. "He's nearly always right."

Is it this time? It's too soon to tell if he will keep up its rapid growth—truly bring the Web into every home. If it doesn't, Clark may just have one up with another crazy idea.

By Robert D. Hof in Mountain View, Calif.

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TELECOMMUNICATIONS

MCI IS FILLING UP ITS DANCE CARD

A latecomer to wireless, it's scrambling for partners

The dealmakers at MCI Communications Corp. are having quite a season. They're in the midst of talks with both GTE and the team of Bell Atlantic and Nynex. Earlier this year, they negotiated—then broke off—a deal to buy a 17% stake in Nextel Communications Inc., an operator of a new wireless phone network. And they have arranged to buy a majority stake in In-Flight Phone Corp.

There's a common thread to all this: The No. 2 U.S. long-distance carrier badly needs to branch out into wireless calling—where rivals AT&T Corp. and Sprint Corp. are already well positioned, thanks to their own dealmaking.

So the deals will keep coming. In October, for example, MCI must finish lining up partners for the Federal Communications Commission's Dec. 5 auction of 2,074 airwave licenses to operate a new form of cellular-telephone system called personal communications services (PCS). Companies that are planning joint bids have to register with the commission by Oct. 28. "The next few weeks are all about being well-positioned to provide the next generation of wireless services," says Mark J. Lowenstein, a consultant with market researcher Yankee Group Inc.

CONNECT CHARGES. The race for partners pits MCI against AT&T, Sprint, and a host of corporate giants. Sprint, for example, is negotiating a joint bid with cable-TV operators Comcast, Continental Cable, TCI, and Cox. If MCI doesn't pick a partner soon, it could be left out of the party.

It's not a party to be missed, but nobody wants to go stag. The commission expects to rake in an average \$5 million per license, and it will cost an additional \$200 million or so to build a network in a major city.



PARTY LINE: MCI may need a Bell's deep pockets

That's why MCI's next deal may be with one or more of the deep-pocketed Baby Bells. MCI executives say the company is close to teaming up with the wireless group created by Bell Atlantic Corp. and Nynex Corp. over the summer. Under current proposals, MCI would provide the marketing muscle in return for a stake in the consortium, currently the nation's second-largest cellular operator. "There could be an announcement shortly," says one senior MCI executive. Bell Atlantic and Nynex would not comment.

In one sense, it would be an odd pairing: In wired service, MCI and the Baby Bells are fast becoming mortal enemies.

In early October, MCI applied to the states for permission to offer local telephone service in competition with the Bells. That's one reason why MCI is double-tracking—pursuing a cellular deal with GTE, too. MCI views GTE as somewhat "less antagonistic" toward it than the Bells, says Albert Grimes, a former MCI executive familiar with the talks.

MCI got its foot in the door with the Nynex-Bell Atlantic group only after Sprint broke off negotiations and started talks with the cable-TV operators. The cable giants had been plotting a concerted PCS bid for months, figuring they can offer nationwide wireless service by integrating PCS with cable systems. But a pure cable coalition would lack a national brand name and experience in operating a phone network. So the cable-TV giants want to team up with a long-distance carrier.

LAST-MINUTE SCRAMBLE. MCI's arrival, AT&T, is still on the prowl, too. Buying McCaw Communications Corp. makes it No. 1 in cellular service. AT&T is trying to expand its reach rather by forging a partnership with Southwestern Bell Corp., says an executive close to the talks. "It's just really a feeding frenzy of dealmaking," says Grimes. "Everybody is talking to everybody."

Even if all these cellular deals are consummated, none of the heavy hitters will be able to offer seamless national service—without PCS, that is. Although cellular operators are restricted from bidding in areas where they already cover 10% of the population, they're free to bid for licenses in regions where they have no presence—just what they need to fill in holes in their service.

In the meantime, the dealmaking continues. "The stakes are so high that I don't believe any deals will be finalized until the 11th hour," says Dennis R. Warrick, president of Time Warner Telecommunications. Looks like no letup soon for MCI's negotiators.

By Mark Lewyn in Washington

WIRELESS WINGDING

An array of wireless deals are being discussed in anticipation of the government's December auction of PCS licenses:

BELL ATLANTIC AND NYNEX' cellular phone venture might team up with a West Coast consortium made up of U S West and Pactel's AirTouch spin-off.

COMCAST, CONTINENTAL CABLE VISION, TCI, COX, and other cable companies have talked about getting together and submitting joint bids with Sprint.

MCI is eyeing deals with the Bell Atlantic-Nynex group and/or GTE.

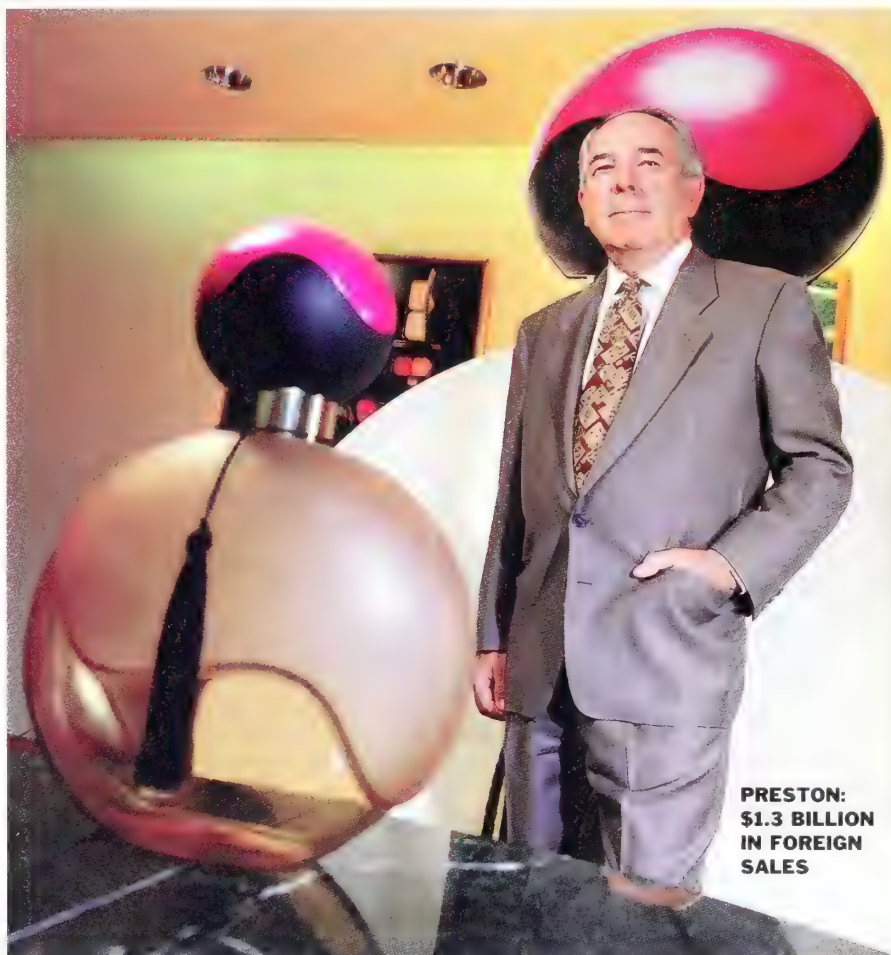
AT&T-McCAW is looking at a partnership with cellular giant Southwestern Bell.

THE AVON LADY OF THE AMAZON

In rain forests to remote
villages, the
of cosmetics is
up across the globe

Susana Reis Teixeira doesn't fit the picture of a typical Avon lady. Clutching a sample kit filled with everything from deodorant to perfume she spends most weekdays visiting wooden shacks in the tiny village of Registro, Brazil. Located just outside São Paulo, Registro bears little resemblance to the manicured U.S. suburbs. It's the customary turf of sales representatives for Avon Products Inc. But emerging markets are proving bountiful for the beauty-aids giant: Its sales in Brazil are expected to climb more than 40% this year, to more than \$300 million. With growth prospects like that, it's no wonder Avon is so interested in emerging economies. From small backwater villages in Brazil to the bustling streets of Shanghai, the New York-based direct marketer has deployed a large army of sales representatives to peddle its wares across the developing world. In addition to Brazil, Avon has established beachheads in 26 emerging markets, including Mexico, Poland, and China. Next on its target list: India, South Africa, and Vietnam by 1997. **THE PROMISE.** Such overseas adventures are taking on a greater significance for Avon as its traditional market in the U.S. falters. While U.S. sales fell 1% to \$1.1 billion last year, emerging markets added \$1.3 billion in sales, an 18% increase. "We see great promise in these markets," says Avon Chief Executive Officer E. Preston, 61, who began his company's big push into emerging markets in 1990. "And we feel the growth is sustainable."

It's welcome news at Avon, whose direct-marketing pitch has lost much of its luster in the U.S. and Western Europe. The pleasing smiles of legions of sales representatives have been replaced by such retail chains as Wal-Mart Stores Inc. in the U.S. and hyper-



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AVON CALLS ON EMERGING MARKETS

MEXICO Avon's biggest market among developing countries, with sales up 16% in 1993, to \$370 million. Since entering market in 1990, has built sales force to 170,000.

ARGENTINA Avon's fastest-growing foreign market, thanks to high economic growth and expanding middle class. Sales, \$220 million in 1993, have grown at a compound annual rate of 43% for past five years.

CHINA Sales have been growing slowly since Avon entered market in 1990, totaling only \$15 million in 1993. But company sees huge potential as economy matures and has deployed a sales force of 25,000.

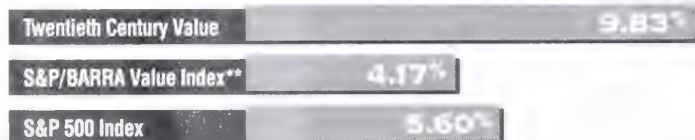
POLAND Became newest addition to Avon's markets in 1993. Avon won't disclose sales figures. But the company is betting on economic turnaround in Eastern Europe.

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Marketing

marchés in Europe, which sell similar products at discount prices. And as more housewives have joined the workforce, Avon has lost potential customers to sales staffers.

Attempts at a comeback in the home market have so far produced disappointing results. The Avon Select program, which offers consumers direct-mail catalogs and toll-free numbers to order merchandise directly, produced only \$45 million in sales in 1993. Meanwhile, the company slashed commissions and sales incentives as part of a cost-cutting campaign last year. The result: Morale among Avon's U.S. sales staff plummeted and sales slumped.



**GOLD NEEDS TO
BOOST U.S. SALES**

Christina A. Gold, president of Avon's U.S. division since last November, has restored full commissions and bonuses to motivate her staff. "The representative is a critical element of the business," says the 46-year-old Gold. "It remains the No. 1 way of reaching consumers." With morale improving, Salomon Brothers Inc. analyst Diana Temple reckons U.S. sales might rise 10% this year, to \$1.5 billion. That growth, combined with robust sales in developing nations, could push Avon's total revenue up 11%, to \$4.3 billion, with profits expected to climb 13% to \$271 million, Temple figures.

LOCAL TRICKS. By comparison, foreign markets still seem ripe for Avon's style of door-to-door selling. Many, including China and Argentina, boast double-digit growth rates. And many lack developed infrastructures and sophisticated distribution systems. That means even big retail competitors to worry about.

Still, these markets can be tricky. Building brand awareness is a big challenge. When Avon entered Poland in 1993, the company advertised in the leading women's magazine, *Twoja Styl*, and in local newspapers. In isolated regions, such as Brazil's Amazon basin, Avon distributed leaflets announcing its arrival. And in China, where consumers are used to shopping at local stores and are suspicious of door-to-door salespeople, Avon is opening showrooms in its branch offices in major cities where shoppers can consult a company cosmetician and sample Avon beauty aids. The big hit with Chinese consumers: a skin

capability: executive programs

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Illustration by Victoria Kann. As seen in BusinessWeek, May 23, 1994, Issue.

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lightening cream developed for Asian women. The company has opened 25 such showrooms in Guangdong and Shanghai and plans 30 more.

Marketing is also critical in recruiting new sales representatives. Ads extolling the earnings potential of Avon representatives are a potent lure in attracting housewives. Sales representatives in Brazil, for example, receive a 30% commission and could earn \$250 to \$700 a month, compared with the national average income of \$245. The chance at additional income persuaded Teixeira, 36, to sign up when her husband became ill in 1989. But with consumers in Registro inclined to buy low-cost products such as deodorant, Teixeira earns roughly \$90 a month.

There are also bonuses for the best performers. In China, for example, top annual sellers can receive a free motor scooter. Avon won't disclose how many sales representatives it has in emerging markets, but it has a total of 1.3 million working abroad, compared with 415,000 in the U.S. Once hired, each representative begins a continuing training process that covers everything from billing to ordering.

RUSSIAN CHILL. Not all of Avon's new markets have been hits. When it entered Russia in 1993, the company felt it could build brand awareness quickly by distributing its products through wholesalers rather than building a sales force. But sales were disappointing, so Avon is now hiring sales representatives. Other markets, such as China, are proving slow to develop. Still, Avon argues that early investment and plenty of patience are fundamental to any emerging-market strategy.

Unfortunately, Avon may not have all the time it needs to establish itself. With sales growing rapidly in such markets as Taiwan, Mexico and Argentina, Mary Kay Cosmetics Inc., is planning to expand into China and Poland next year. And then there's Avon's old nemesis, Wal-Mart. The retail dynamo and its joint-venture partner, Cifra, a Mexican chain, will have more than 60 stores by yearend. Next year, Wal-Mart is planning outlets in Argentina, China, Brazil, and Hong Kong.

For now, Preston figures Avon has a good headstart. He expects developing markets to account for more than 35% of total sales this year. And he believes Avon's sales can grow by about 19% a year over the next few years. That's a tall order. But Preston insists that Avon has only started to tap the riches of emerging markets. It will be up to Teixeira and Avon's other front-line troops to prove him right.

By Veronica Byrd in New York, with Wendy Zellner in Dallas

People

ENTREPRENEURS

JIM HINDMAN: INVESTING IN TEEN TURNAROUNDS

The ex-Jiffy Lube boss is making profits out of his passion

Deep in the Catoctin Mountains, just over the hill from central Maryland's Camp David Presidential retreat, 58-year-old W. James Hindman strides purposefully along the tree-lined paths of what could easily be mistaken for a summer camp. It's not. Surrounding much of the compound is an imposing 18-foot fence. And the teenagers who sidle up to Hindman as he makes his way to the main administration building are here because they have been convicted of burglary, assault, and drug trafficking. This is a reform school called the Victor Cullen Academy. Jim Hindman is the boss. "They respect me because I'm strong," Hindman says. "I get things done."

Indeed he does. Over the past two decades, the idiosyncratic entrepreneur has not only helped create an industry out of quick oil changes for autos but has also bought and sold 25 nursing homes and coached a Division III college football team to national ranking. Most recently, he persuaded Wall Street to help finance the care and feeding of 1,200 juvenile delinquents, despite the failure of his last public enterprise, Jiffy Lube International Inc. Cullen Academy is but 1 of 13 facilities nationwide that Hindman has bundled into a company called Youth Services International Inc. (YSI). In February, he took it public, and now holds 31% of the stock.

STOCK SURPRISE? For Hindman, YSI is both a business and a passion. He's proud that it turned profitable in the fiscal year ended in June—showing a \$2.1 million gain on \$34.9 million in sales. But he's far more likely to trumpet YSI's

human successes. With a ratio of one teacher for every six or eight students, the schools have raised reading levels as many as four grades in some cases. Hundreds of delinquents who were headed for criminal careers are now working, back in school, or in the military. The joy, Hindman says, is in "taking somebody's discards and making them beautiful."

At the moment, investors are failing to see the beauty in YSI's stock. Since



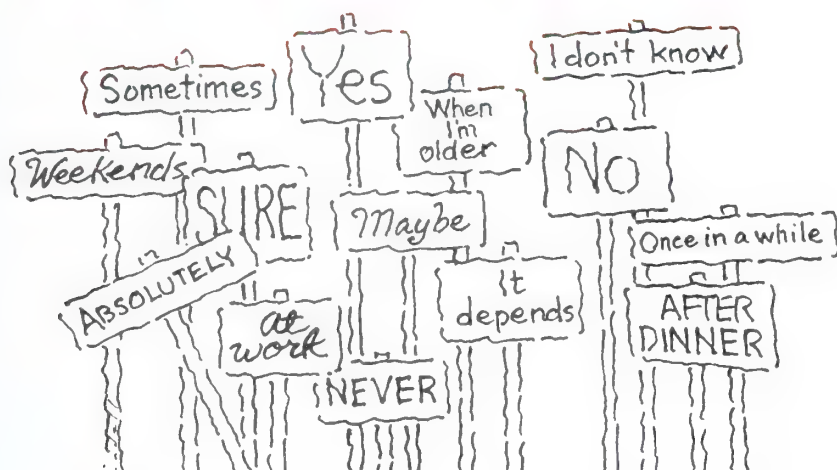
HUMAN SUCCESS: Hindman at the Victor Cullen Academy

going public at 10, the shares have slipped to about 7% "It's a concept stock and the current earnings level doesn't support the stock price," says Paul R. Kuster, senior vice-president at Frégnere Capital Management Inc., a Minneapolis firm that sold its 65,000 shares last spring.

Hindman, however, is convinced the company's cost-efficiency will create a double-digit growth and earnings over the long run. By promising savings of 20% to 30% over the cost of state-run facilities, he is an easy sell to state officials. Hindman shaves expenses by limiting u-

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reacuracy and using stock options to augment pay. He also puts the students to work on maintenance and facility rehabilitation.

YSI sells itself on the quality of its programs. Unlike many juvenile corrections institutions, each of the schools is fully accredited, and students can earn graduate equivalent degrees. Hindman has personally set aside \$1 million in stock as a scholarship fund for kids to tap into after they leave. YSI students get work experience, too, by running such real-life businesses as a restaurant at an Iowa college and an on-site bakery at Cullen Academy. Smitten Iowa legislators this year authorized two pilot programs modeled partly on YSI. "I'm impressed with their combination of discipline and academics," says Iowa State Senator Paul Pate.

"CRIMINAL PATH." Hindman's enthusiasm for helping kids stems from his own tough upbringing. After his father abandoned the family early on, Hindman's mother put him and two younger brothers into a Sioux City (Iowa) orphanage. There, he says, he was sexually abused by a visiting minister. "I was definitely on a criminal path," he says.

But Hindman also got enough stern discipline that his anger was kept in check. His salvation was sports. He parlayed his talent as a linebacker into a football scholarship at Sioux City's Morningside College and then earned a master's in hospital administration at the University of Minnesota. In the mid-1960s, rescuing financially troubled Baltimore County General Hospital developed his taste for turnarounds. He started buying, improving, and selling nursing homes, eventually expanding to 25 residences and earning his first \$1 million by age 35.

Free to do what he liked, Hindman started coaching football. Known as "The Millionaire Coach," he moved from the Community College of Baltimore to Western Maryland College, where he turned the once hapless Green Terrors into contenders. By 1977, Western Maryland had posted a 7-1-1 record and a national Division III ranking. Hindman's method: grueling 6:30 a.m. practices and motivational talks larded with Vince Lombardi quotes and his own life's hard lessons. "Whatever he does, he does

with a vengeance," says Randy M. Heck, a Connecticut hedge-fund manager who played for Hindman.

Jiffy Lube started on a whim. After one of his players complained that it was no longer possible to become a millionaire by building a business, Hindman decided to prove him wrong. Judging that the demise of the local gas station would spawn enormous demand, Hindman acquired seven quick-lube shops based in Utah. He quit coaching to

away with \$2.3 million but now says net worth tops \$20 million.

Stephen Spinelli, a former West Maryland football player who runs nursing home for Hindman and later came a Jiffy Lube franchisee, has mixed but kind words for his old coach. But, Spinelli says, "when he believes something, it's hard for him to stoping forward." You wouldn't see a scene at McDonald's: Spinelli a group of unhappy franchisees were

caucusing in a hotel room before a negotiation session with Hindman. The coach stormed upstairs and kicked the door railing about closed-door meetings. Remembers Spinelli, "I ended up having to pay for **PASSING GAME.** Hindman is a tough guy boss. (He makes staff answer phones by the ring, for instance.) But censored by the Jiffy Lube experience, Hindman says that won't repeat his mistakes. One, he runs YSI tightly from headquarters. And he has rounded himself with a group of solid managers, including former Maryland National executive and several corporations experts. Moreover, Hindman is steering clear of real estate this time. He leases not all YSI's homes in such states as Iowa, South Dakota, Tennessee and Utah.

The question is, will the coach let his professional managers make smart decisions that may disagree with? "Jiffy probably one of the best entrepreneurs I've been associated with, but his shortcomings in management," observes David P. Remey, a New Jersey venture capitalist who helped finance Jiffy Lube. "The guy starts the business often

the best guy to run it once it gets going. For now, however, Hindman is taking in the fact that the Cullen football team he helps coach is 4-1 in its first season. Making a bunch of hard-core teenagers believe in themselves on each other on the football field is an important step in solving the national crisis of gangs, drugs, and general lawlessness, he says. Hindman knows that Wall Street's scrutiny will keep him on the straight and narrow financially. But when it comes to helping out disadvantaged kids, profits aren't necessarily everything.

By Joseph Weber in Sabillasville, Md.

Hindman's Winding Career

BORN RAISED

Nov. 10, 1935, in Volin, S.D.
Boys & Girls Home, a Sioux City (Iowa) orphanage.

EDUCATION

BA, social psychology and business administration, Morningside College, 1957. MA, hospital administration, University of Minnesota, 1959.

NURSING HOMES

Bought and sold nursing homes privately. Made first \$1 million from 1967-69. Owned 25 nursing homes at one point. Still lives next to his first nursing home: Chapel Hill Convalescent Center near Baltimore.

FOOTBALL

Known among his players as "The Millionaire Coach," he worked the sidelines from 1968-80 at Community College of Baltimore and Western Maryland College.

JIFFY LUBE

Founded Jiffy Lube International in 1979. Unloaded it in a distress sale to Pennzoil in 1990. Net worth topped \$100 million at Jiffy Lube's peak.

REFORM SCHOOLS

Founded reform school operator Youth Services International in 1991, investing about \$1 million. His 31% stake is worth about \$11 million. Company operates 13 facilities nationwide. Revenues: \$34.9 million. Profits: \$2 million.* Hindman's son teaches at a YSI school, his daughter is a YSI director.

*Figures for fiscal year ended June 30, 1994

build a national business.

Hindman's instincts proved solid, but his methods were born of the locker room. In his drive to make Jiffy Lube a national player, he not only hired many of his former players as franchisees but also helped set them up. He offered liberal terms and even acquired real estate for them. Eventually the debt grew too heavy, and Jiffy Lube defaulted on more than \$69 million in debt in 1989. That drove the stock—which once topped \$40 a share—into single digits and allowed Pennzoil Co. to buy the company for about \$100 million in cash and debt assumption. Hindman walked

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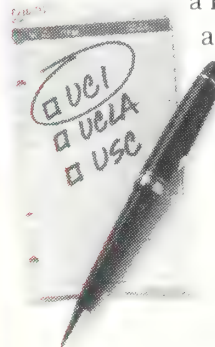
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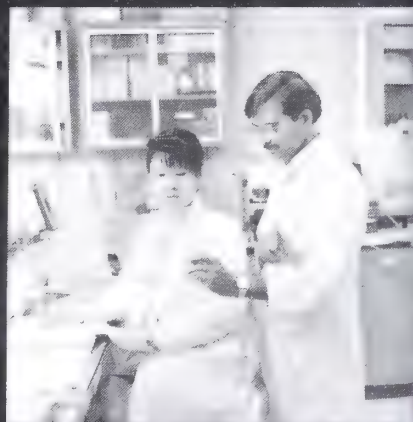
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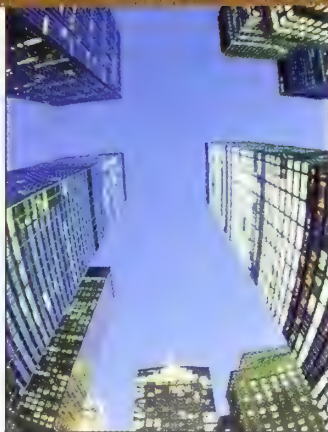
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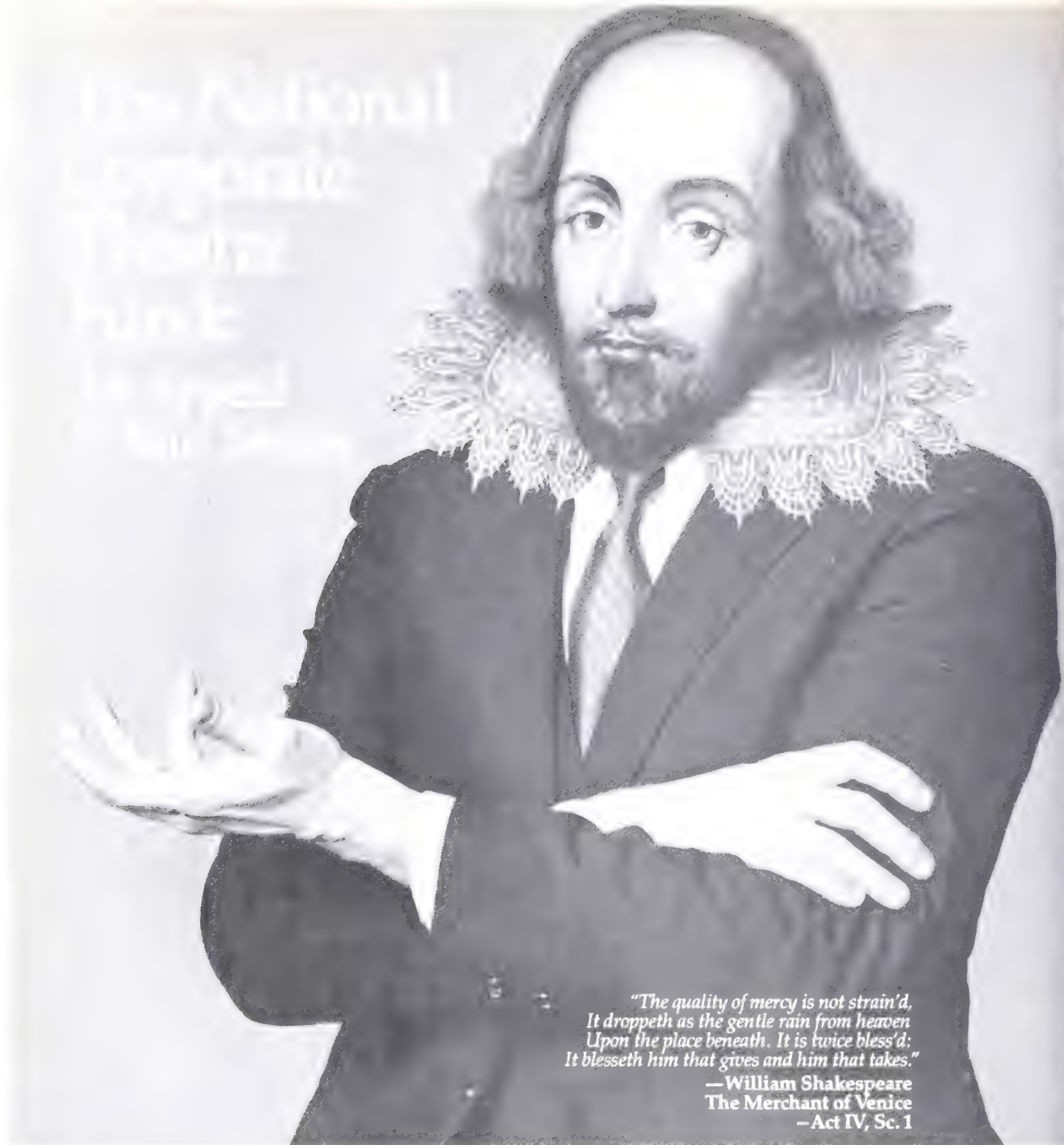
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**—William Shakespeare
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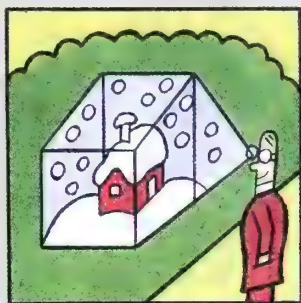
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BY EMILY T. SMITH

PLER. ER WAY TO CHIPS

SLICE A SEMICONDUCTOR and look at it under the microscope, you will see layers of superthin crystalline materials with these flawless lattices. The product of several of the world's most complex manufacturing processes: atoms are deposited from various chemicals, others are etched from beams of molecules. Scientists have refined these approaches to the point where they can deposit chemicals a single atom thick. Each step requires high temperatures, which excite atoms and mix them up. At the University of Georgia, chemist John Stickney believes he can achieve comparable results with well-established electroplating techniques resembling electroplating. Using an electric current to alter the chemical composition of a chemical solution, he can deposit layers of atoms on a substrate to produce a compound semiconductor. The best part: The bonding is done at temperatures as low as a few degrees Celsius, much lower than required by techniques relying on chemical or molecular beams—techniques that require atomic activity. These techniques are nearly

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COMING SOON TO A LIVING room near you: 3-D glasses with built-in TV screens. Virtual I/O Inc., a Seattle startup, has designed a pair of "i-glasses!" that gives the wearer what amounts to a private video screening. It does this by shining images from two liquid-crystal displays—one for each eye. Virtual I/O

uses special mirrors and lenses to remove such problems as curved or clipped-off images and color distortion. One version actually tracks movements of the head, for video games in which the scene you're viewing changes as you turn your head left or right. The tracker works by measuring how the glasses move with respect to the earth's magnetic field.

Of course, no one will want the glasses without programs or games that exploit their features. Luckily for Virtual I/O, it's partly owned by Tele-Communications Inc., the nation's largest cable operator. TCI says it plans in the coming year to broadcast programs and distribute video games that will appear in 3-D to people wearing i-glasses!. Right now, people watching 3-D without the glasses would see a bad picture, but Virtual I/O says TCI will correct that problem soon. Virtual I/O plans to produce the glasses in volume next year. They'll sell for about \$599, or \$799 for the head-tracking version.

100 years old. Computer-disk-drive companies have used electrodeposition, for instance, to make thin-film recording heads for hard-disk drives. But tailoring the tech-

nique to single-atom dimensions calls for a whole new set of control standards. So Stickney says he must ratchet up the film quality before talking to chipmakers.

THROWING THE OFF-SWITCH IN TRANSMUTED MICE

IN MANIPULATING GENES TO fight disease, timing is all. In hereditary breast cancer, for example, the problem gene malfunctions at a particular time, and only in specific cells of the breast. Since genetic experiments on people are next to impossible, what researchers want is an animal experiment that mimics the course of a disease in humans.

Biologists have learned how to plant normal and disabled genes in so-called transgenic mice and study the results. But such tests are too imprecise to shed much light on how diseases develop. Last month, however, National Institutes of Health researcher Lothar Hennighausen and Dr. Priscilla Furth at the University of Maryland School of Medicine described a way to switch the genes on and off at will. They use artificial "promoter" genes constructed from bacterial and viral components. These bond with injected tetracycline to create new molecules that can stop the target mouse gene activity. In theory, this advance could lead to injections that would halt errant genes before they trigger a disease.

S GENE KEEPS YOUR BLOSSOM IN BLOOM

ING A CORSAJE IN THE garden may extend the life of a flower a few days, but the flowers will live. Once a flower is pollinated by insects, it is programmed to self-destruct. The plant automatically recycles nutrients from pollinated petals to produce new seeds and fruit.

Now, a team of Purdue University researchers may have figured out how to outsmart a flower's self-destruct program. And that could be a

boon to the \$7 billion floral industry, which figures that flowers will sell better if they last longer. When a bee pollinates a flower or when a flower is cut, the flower produces a hormone called ethylene. This hormone turns on genes that produce enzymes, which then break down the petal's carbohydrates and proteins—and produce still more ethylene.

To thwart the process, Purdue horticulture professor William R. Woodson and



WOODSON: His team found the wilt button in flowers

graduate students Hanan Itzhaki and Julie M. Maxson have taken an altered copy of the gene that controls the death of petals and inserted it into carnations, rendering them insensitive to ethylene. These genetically engineered carnations lasted three weeks after cutting, vs. the normal three to five days. Since some of these same genes control the dropping of fruit, the research has the potential to boost harvests by keeping fruit on trees until it's truly ripe.

AIDS: MAYBE THERE ISN'T A MAGIC BULLET

Led by the NIH, the war against AIDS is scaling back big clinical trials in favor of fundamental science

The numbers in the AIDS epidemic are staggering. Thirteen years after the disease burst on the scene, it has killed 243,000 Americans. An estimated one million people in the U.S.—17 million worldwide—are infected by HIV (human immunodeficiency virus), while in some parts of Asia new infections have soared tenfold in four years. Besides the human toll, there are other humbling statistics. Since the early 1980s, the U.S.'s biomedical research Establishment has spent more than \$6 billion in the hunt for weapons against HIV. The number of completely effective drugs or vaccines so far: zip. And "there's not much else coming up the pipeline," says immunologist Irvin S. Y. Chen, director of the AIDS Institute at the University of California in Los Angeles.

That's why the National Institutes of Health, led by its new chief of AIDS research, immunologist Dr. William E. Paul, is orchestrating a profound and controversial shift in the direction of research. The central idea: Instead of rushing promising treatments into large clinical trials, scientists should go back to answering fundamental questions about how the virus disrupts the body's immune system. "We have to redouble our efforts to get more basic informa-

tion," says Nobel Laureate David Baltimore, a molecular biologist at Massachusetts Institute of Technology and a top adviser to Paul.

More than a decade after HIV was identified, in fact, it's sobering to realize how mysterious AIDS still is. While tantalizing clues are beginning to emerge, scientists aren't sure how the virus kills key cells. They don't know whether the immune system is capable of defeating the virus—or whether an active immune response is part of the problem. And it's unclear why infected victims remain free of symptoms for years before the disease takes hold. In short, Paul says, though "we've come from nowhere to a situation where we know an enormous amount," science's grasp of how the virus works "is not what it ought to be."

SHORTCHANGED. Part of the ignorance results from the complexity of AIDS. With the wisdom of hindsight, moreover, much of the government's \$5 billion-plus in AIDS research outlays might have been better spent. Because AIDS activists, Congress, and many scientists wanted to rush treatments to victims, vast sums were lavished on large clinical trials. They were used to deliver care as well as to evaluate such drugs as AZT. And basic science was shortchanged. "When Congress was pumping money in, they were asking: 'How many patients do you have on clinical trials? What, only 500? You should have 1,000,'" recalls Dr. Anthony S. Fauci, Paul's predecessor as head of NIH's AIDS research. "I would dutifully say, 'Mr. Chairman, the number doesn't

make any difference—you gotta ask the right questions.'"

Such questions—about both the chemical details of the virus' range and the best way to use, say, AZT's cousin, ddC—typically weren't addressed, however. "With better [research] five years ago, we'd have answers today," says activist Carlos Gonsalves of the Treatment Action Group. "It's hard to make the case that money was not wasted."

Paul and his advisers aim to fix that. The new plan shifts millions of dollars from clinical trials to more fundamental lab and animal studies. It also will squeeze far more basic information out of clinical trials themselves by adding regular measurements of such key parameters as the total amount of virus in the body—tasks for which both training and technology were insufficient until now. Inevitably, however, given the AIDS budget that won't grow past current \$1.3 billion per year, boosting basic science and adding costly lab work will mean fewer, smaller trials. In 1994, scientists expect the network of high-powered clinical trials to shrink from 33 sites to 20 next year.

With a disease as politicized as AIDS, the prospect of such downsizing is already stirring opposition. Clinicians worried about losing their trials are certain to plead with sympathetic lawmakers on Capitol Hill. Once as trials are shut down, "there will be a very unhappy people," warns Robert Schooley, incoming director of the

AIDS: Shifting Focus

More than a dozen years after the AIDS epidemic began, there are still major gaps in the understanding of the deadly disease. That's why the National Institutes of Health is taking the controversial step of shifting money from clinical trials back to the lab bench. Here's what scientists need to learn—and why:

WEAPONS Which part of the immune system—antibodies, killer cells, or something else—is the best weapon. Figuring out which component to boost—or suppress—is crucial to vaccine development.

METHOD How the virus actually destroys vital immune-system cells. It's difficult to protect them without first understanding why they die.

TARGETS The functions of the genes in the virus. It may be possible to disable one that does not mutate fast enough to elude the immune system or drugs.

LOCATION In which cells the virus lurks at different stages of infection. The answer may explain how it eludes the immune system and suggest new treatments.

and AIDS Clinical Trials (ACTG). Adds re-
John Moore of the
Diamond AIDS Re-
center in New York:
going to be nasty

the NIH's Paul ap-
ruffled by that pros-
some people find this
basics' idea fright-
d unwise," he con-
But I am hopeful a
is not in the offing."
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"A lot of us have
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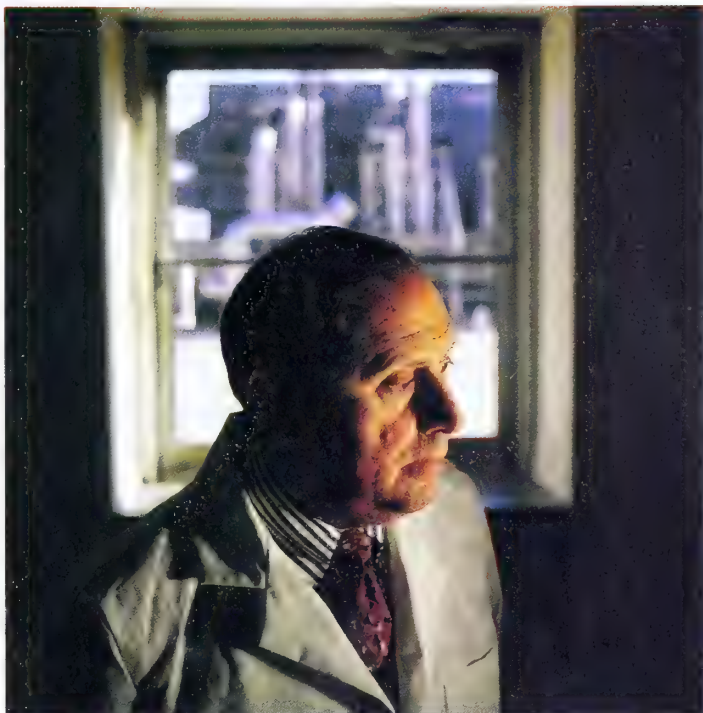
and generating promising ide-
ure treatments.

TARGET. One mystery of AIDS
ntibodies don't stop HIV. In dis-
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mpt the immune system to
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But first-generation AIDS vac-
m Genentech Inc. and others,
e based on one entire protein in
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scientists are figuring out why.
et to stopping HIV from infect-
says immunologist Susan Zolla-
f the Manhattan VA Medical
s binding to just a tiny, specif-
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Why a handful of people
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the virus harnesses the
o replicate itself, and
so gets a crucial boost when
system kicks in. It may be
lock that process.



MORE CONFLICT?

“Some people find this back-to-basics idea frightening and unwise. But I am hopeful a civil war is not in the offing”

—DR. WILLIAM E. PAUL

stitute in La Jolla, Calif., researchers have gone even further, engineering similar natural antibodies to make them 10 times as potent. “Anything that reduces the viral load has the possibility of being very beneficial,” explains Scripps’s Dennis R. Burton. There’s interest in commercializing these antibodies, but no trials are set yet.

Unfortunately, antibodies can tackle only viruses running free through the blood. In AIDS, scientists now know, that’s not enough. The reason is that the virus hides inside cells—it may even be transmitted that way. So researchers are trying to find ways to boost another component of the immune system, so-called cytotoxic lymphocytes (CTLs) that can kill infected cells. In one promising approach, companies such as Vical and Viagene are using gene therapy to slip viral genes into human cells. When the cells begin to make the protein coded for the gene, they seem to turn on the CTL response.

The virus continues to throw curves, however. In one of the most exciting—and perplexing—recent experiments, Ronald C. Desrosiers of the New England Regional Primate Research Center seems to have protected monkeys from the simian equivalent of AIDS by vaccinating them with live, weakened virus. Trouble is, the key parts of the immune system don’t appear to be playing a role. The monkeys “don’t have neutralizing antibodies; they don’t have cytotoxic cells,” says Fauci. “Why in God’s name are they protected?”

The answer to this and other vital questions may come from a scientific gold mine. Over the past couple years, Fauci, Dr. David D. Ho of the Aaron Diamond center, and others have identified people who have been infected for more than a decade but show no signs of AIDS. “Their immune system seems to be winning,” says Aaron Diamond’s Moore. Now, says Fauci, comes the “trench work” of finding the reason.

HORMONE HOPES. In the meantime, basic science is making progress fighting the secondary diseases caused by AIDS. In the National Cancer Institute lab of HIV co-discoverer Dr. Robert C. Gallo, for instance, researchers have made a potential breakthrough for Kaposi’s sarcoma, once known as gay cancer. To study the disease, researchers grew sarcoma tumors in immune-deficient mice. But when a lab worker injected sarcoma cells into a female mouse by mistake, says Gallo, the tumors failed to grow. “It was a huge surprise,” he says. A female hormone, produced during pregnancy, appears to stop the cancer.

Such successes offer hope that boosting basic research will bring an end to the epidemic. But the shift in policy is also an admission of failure. The high hopes of quickly producing effective drugs and vaccines are long gone, replaced by a new urgency about learning AIDS’s hidden secrets. “Knowledge doesn’t equate to a cure,” says Moore. “But without it, we won’t find a cure unless we stumble on it.”

By John Carey in Washington



EDITED BY AMY DUNKIN

A BIGGER ROLE FOR SMALL FRY IN YOUR PORTFOLIO?

When the managers of Heartland Value fund pick stocks, they seek companies with an average market capitalization of just \$75 million and "a price chart that looks like a dead man's heartbeat." They prefer small, undervalued companies with some hidden catalyst that will kick up the price. Take Nichols Institute, an \$81 million California lab-testing company. It had strong operations and lots of cash yet was overlooked by Wall Street. When acquirer Corning saw what Heartland saw, the fund sold its stake for a \$3.75 million profit.

Such opportunities are more prevalent among small companies because they are less scrutinized on the Street. That's one reason investors have been piling into small-cap and so-called microcap funds in this picked-over market.

BUSINESS WEEK defines small caps as companies with \$200 million to \$750 million in market capitalization, with microcaps \$200 million or less. But the definition of small varies depending on who's counting. Morningstar, which tracks mutual funds, defines it as any

tial category in any investment portfolio. Fast-growing smaller companies provide the highest returns and add diversification to a portfolio of blue chips. Although the little guys took a dive during the stock-market correction this spring, in August they roared

ter they averaged 6.9% versus 4.9% for the Standard & Poor's 500-stock index and 6.8% for the Dow. And experts say the rally that began in 1991 is far from over.

Other factors make small caps compelling now. Strong earnings and growth

INVESTING

The number of small-cap funds has risen from 84 to 227 in five years, and assets have almost quadrupled

company under \$1 billion, while the soon-to-be-released Standard & Poor's small-cap index defines small as roughly \$80 million to \$600 million.

By any measure, though, small- and microcap stocks are being recognized as an essen-

tial category in any investment portfolio. Fast-growing smaller companies provide the highest returns and add diversification to a portfolio of blue chips. Although the little guys took a dive during the stock-market correction this spring, in August they roared

potential should carry through an economy softened by rising interest rates. Stocks should remain cheaper than they were throughout most of the 1980s. And they should fit from an influx of money into the increasingly popular

f small-cap funds. The of funds has risen t five years ago, to an 227 now—and asse e almost quadrupled. he confusing defini- n make finding the all-cap more difficult eeds to be. For ex- he reigning small-cap or the past five years, ed by Morningstar, even consider itself a p fund. The Oppen- Main Street Growth e fund has a five-year e annual return of Although fund man- Wallace isn't limit- ize, and 25% of his o is in bonds, he at- much of the fund's to small caps.

Heartland managers, looks for a catalyst e a stock up. He I International, a lion, well-managed tance phone com- at should grow at 25%, or twice the rate. The catalyst: ansion into new on the East Coast. sees hidden value uware, a \$2.1 bil- er of productivity e for mainframes. hough the main- usiness has slowed, critical applications l used, he says. are expected to 30% over the next rs.

RGE? Wallace also a strict sell disci- arting to unload a y when its price drops at to absorb the \$1.3 in assets that have into the fund, he has into big companies, Philip Morris, Nike ational, and Block- Entertainment. As a e's already edging out small-cap realm.

lluminates a key prob- small-cap funds. If they ecessful and attract they have to head for companies or close to mbers. This was the h No.2 small-cap fund egressive Growth, which

closed its doors last May when its assets hit \$650 million. "If the fund gets too large, you can't participate in small companies in a meaningful way," says AIM manager Bob Kippes.

Doors may be closing by yearend at PBHG Growth fund, where money is pouring in at a rate of \$60 million to \$80 million a month. PBHG has returned an average annual 19.9% over five years. Fund manager Gary Pilgrim follows a strict earnings discipline. "Earnings surprises and revisions are the most important part of how we rank stocks," he says. "As soon as they start tipping into deceleration, we get out."

Twentieth Century Gifttrust, with a five-year average annual return of 19.28%, limits

Royce, whose Quest Advisory manages microcap Royce OTC Fund, which has earned over 20% a year since it started in 1991. Royce believes that microcaps today represent the same opportunities that small-cap companies offered 10 years ago. Because risk rises as company size drops, Royce looks for small companies with a proven track record. Dress Barn at \$200 million is typical. It has a high-quality balance sheet in a cyclical industry, and its stock is off 50%. Companies like this, on which most investors have soured, represent true value to Royce. **HEAVY WEIGHT.** Although most microcap funds are fairly new, Heartland Value, the top in microcaps for the last five years, has been stock shopping

all large-cap portfolio. Aim for a mix of growth and value stocks, because one is usually doing well while the other isn't. Over the past 20 years, the average annual return for small caps is 17.3% (20.4% for microcaps), compared with 13.6% for large caps, according to Satya Pradhuman, vice-president for quantitative analysis at Merrill Lynch. Add to this the "small-cap effect," whereby the little guys tend to provide higher returns with less risk than would justify those returns. "We all know equities are the one solid way of building real wealth outside of inflation," says Quest Advisory's Royce, "and if you're ignoring small companies, you're ignoring the best way to do it."

Some Top Small-Cap Funds

	FUND	ASSETS	RETURNS		MEDIAN MARKET CAP	LOAD/FEE
			YR TO DATE	5 YRS		
SMALL CAPS (\$200-\$750 MILLION)	OPPENHEIMER MAIN STREET INCOME & GROWTH A	\$1.3 bil.	0.07%	23.09%	\$716 mil.	5.75%/1.23%
	AIM AGGRESSIVE GROWTH	650 mil.	8.1	21.78	376 mil.	closed/1.00%
	PBHG GROWTH	590 mil.	-2.5	19.99	660 mil.	1.5%/2%*
	TWENTIETH CENTURY GIFTRUST	234 mil.	5.88	19.28	381 mil.	none/1.00%
MICROCAPS (UNDER \$200 MILLION)	HEARTLAND VALUE	301 mil.	3.8	15.26	44 mil.	none/0.51%
	HOTCHKIS & WILEY	13.9 mil.	0.14	11.78	173 mil.	none/0.48%
	T. ROWE PRICE SMALL CAP VALUE	438 mil.	1.84	11.98	128 mil.	closed/0.98%
	BERWYN	54 mil.	3.74	10.59	101 mil.	1.37/1%*

* Redemption

DATA: MORNINGSTAR INC.

its asset size by a unique investing approach. You can only use this fund to make gifts to someone other than yourself and your spouse, and the investment must stay in the fund for at least 10 years. This "forces people to be good long-term investors," says spokesman Gunnar Hughes. People tend to make small contributions, and the fund is popular with parents and grandparents seeking a way to save for their children.

As small caps get discovered, microcaps become "the final frontier," says Chuck

with a magnifying glass since 1984. The fund has outperformed the Russell 2000 index each of those years except one. Co-manager Hugh Denison relies on local brokers to pick such undervalued stocks as Norstan, a \$33 million telecommunications company trading at about 12 times earnings and 1½ times book value.

If you're too heavily weighted in small-cap stocks, you take on greater risk. But many investors don't realize that a modicum of small caps, say 10% to 15%, actually reduces risk by diversifying an

If you have a time horizon beyond five years, especially if saving for retirement, you're missing out by not capturing that extra return. According to Ibbotson Associates, your chances of profiting with small-cap investing are high after 10 years—and almost certain after 20 years. If the risk still bothers you, PBHG's Pilgrim advises, "be very conservative about money you think you might need over the next few years." Then you can use small-fry funds to help put some punch into the rest of your portfolio. *Pam Black*

IT'S HIGH TIME FOR BIRD-WATCHING

Some came alone, others in pairs, and still others by the dozens. For hours, they flew over swamps and dunes. The falcons seemed to be in the biggest hurry, deviating from their flight path only to snag a dragonfly or hunt another bird. Broad-winged hawks drifted leisurely in search of warm currents rising from the land. Ospreys soared overhead majestically, like eagles.

At the annual hawk watch at Cape May Point, N.J., upwards of 35,000 birds of prey put on a wondrous display as they migrate from as far north as Greenland to as far south as Argentina. From late August through the first chill days of December, hawk-watchers flock to this seaside Victorian resort town to see the birds on their journey.

It's not the only hot bird-watching spot this time of year. Others include Duluth, Minn.; Whitefish Point, Mich.; and Goshute Mountains, Utah. The top of New York's World Trade Center is a prime location, as are Ontario's Holiday Beach, the Santa Ana National Wildlife Refuge in Texas, and Hawk Mountain in Pennsylvania.

Hawk Mountain that have watching got its start in 1934, when conservationist Rosalie Edge raised money to buy the rocky plateau from which local gunners slaughtered hawks for sport. These days, it's Cape May that has a special allure for both birds and bird-watchers. The peninsula is known as a land funnel: Seeing a vast

stretch of water to the east, west, and south, birds converge over the cape to rest and eat before continuing on their long passage.

So far this season, more than 12,500 sharp-shinned hawks and American kestrels have been spotted.

The town has made bird-watchers equally welcome by

OUTDOORS

spring hawk migration north isn't as much of a spectacle as the journey south; the birds come back in dribs and drabs. Spring is the time to look for warblers and shorebirds heading north from South America.)

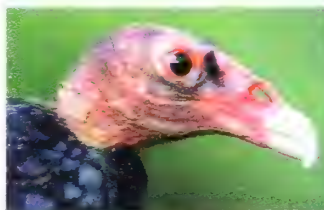
It doesn't cost a lot to get into the sport. The most critical requirement: binoculars.

Birding Guides

NATIONAL GEOGRAPHIC SOCIETY FIELD GUIDE TO THE BIRDS OF NORTH AMERICA (Random House, \$21). Hailed by birders for its accuracy, the book features paintings and drawings that render average likenesses of birds, useful because of the range of variabilities even among birds of the same species.

PETERSON FIELD GUIDE TO HAWKS by William S. Clark and Brian K. Wheeler (Houghton Mifflin, \$15.95). This handy guide provides drawings, photos, and silhouettes of raptors in flight.

THE BIRDER'S HANDBOOK by Paul R. Ehrlich (Simon & Schuster, \$17). A book that offers fun facts about birds, such as feeding and nesting habits and gestation periods.



ON THE MOVE: Turkey vulture and peregrine falcon

building an elevated platform near the base of the old lighthouse. The Cape May Bird Observatory (609 884-2736) offers field trips and lectures, ranging from August Hummingbird Extravanzas to Hawk I.D. Mini-Workshops in September and October. **LONG JOURNEY.** Perhaps the greatest tutorial for would-be hawk-watchers is held at Cape May Point all day, every day through Nov. 27 on the elevated platform. Just bring a set of binoculars, and you can work side-by-side with official bird-counters, who will help you learn to spot and identify the 19 species of hawks and eagles cruising overhead. (The

Expect to spend at least \$300 for a durable, lightweight pair that can focus quickly. Make sure the glasses fit the grip of your hand. You will be hold

ing them up for hours at a time, so you may want anything heavier than ounces. You also want to get away from glasses, higher magnifications—a range of, say, 10—since the harder to focus, and your smaller field of vision.

"AT PEACE." If getting equipment is easy, learning the ropes of bird-watching is not. Becoming proficient takes lots of experience in the and attendance at lectures. A good way to start is by joining the \$20 introductory to join the National Audubon Society in New York (800 4201). Another resource is the American Birding Association, Colorado Springs, Colorado (634-7736).

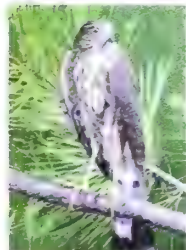
Birders spend hours looking into the sky, noting shape, tail length, and manner of flight to identify birds that appear as dots. Knowing differences among species enables veteran birders to go through a process of elimination to determine which one they're sighting.

The intellectual stimulation of the detective work isn't only attraction. For Mae Murgitroyde, a volunteer at Cape May Point who has been birding for 15 years, it's a way to relieve stress. "I'm totally at peace when I'm birding," she says. If you need a relaxing break from the daily grind, you're just a pair of binoculars away. *Christina Delaney*

WORTH NOTING

■ **IRS WOES.** If you and the Internal Revenue Service don't see eye to eye, the worst thing you can do is ignore the problem, says tax attorney Martin Horwitz of Cincinnati. *How to Survive Your IRS Crisis*, his two-hour video comes with a manual and worksheets. Call 800 310-1010 to order the \$59 kit.

■ **TRAVEL TIPS.** People not privy to the secrets of seasoned travelers—such as how to get more legroom on flight or avoid hotel-phone surcharges—can get some handy advice from *202 Tips Even the Best Business Travelers May Not Know* by Christopher J. McGinnis (\$10, Irwin Professional Publishing).



REST STOP for a hawk

start in 1934, when conservationist Rosalie Edge raised money to buy the rocky plateau from which local gunners slaughtered hawks for sport. These days, it's Cape May that has a special allure for both birds and bird-watchers. The peninsula is known as a land funnel: Seeing a vast

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Customerize \ kūs'-tā-mā-rīzē' \ *vt*
to make a company more responsive
to customers and better able to attract
business. **2:** to customerize an organi-
zation's information strategy, e.g., to
use systems capabilities to
locate and other points of
customer contact and support. **3:** what
Unisys Corporation does for a growing
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agencies, worldwide. **syn** see CUSTOMER-
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SOLUTIONS, REVENUE GENERATION

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Chemical Waste Management

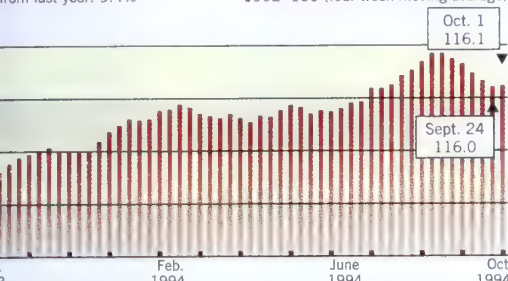
10000 W. 10th Avenue, Suite 100, Denver, CO 80231

Business Week Index

PRODUCTION INDEX

from last week: 0.2%
from last year: 9.4%

1992=100 (four-week moving average)



Production index rose in the week ending Oct. 1. Seasonally adjusted output of autos, trucks, crude-oil refining, and paperboard fell, and output rose in steel, coal, paper, lumber, and rail-freight traffic. The unaveraged index hit 115.9. In September, the index fell to 116.5, from August's 118.8. The index has been updated to reflect new 1992 weightings of its components. The monthly history is available from BUSINESS WEEK.

BW production index copyright 1994 by McGraw-Hill Inc.

PRICING INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
WEEK LEADING INDEX* (10/1)	245.92	246.07r	8.0
STOCK PRICES (10/7) S&P 500	456.98	462.53	-0.8
BOND YIELD, Aaa (10/7)	8.57%	8.48%	27.5
COMMODITY MATERIALS PRICES (10/7)	108.2	108.1	15.4
INDUSTRIAL FAILURES (9/30)	293	317	-17.5
CREDIT RISK (9/28) billions	\$440.3	\$440.3r	6.2
CREDIT SUPPLY, M2 (9/26) billions	\$3,562.4	\$3,558.4r	1.8
CLAIMS, UNEMPLOYMENT (9/24) thous.	310	321	-5.8

*Center for International Business Cycle Research (CIBCR), Standard & Poor's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of companies), Federal Reserve, Labor Dept. CIBCR seasonally adjusts data on failures and real estate loans. *Copyright 1994 by CIBCR.

INTEREST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
BANK FUNDS (10/11)	4.71%	4.78%	2.91%
GOVERNMENT PAPER (10/12) 3-month	5.53	5.46	3.25
RATES OF DEPOSIT (10/12) 3-month	5.52	5.50	3.22
MORTGAGE (10/7) 30 year	9.03	8.91	6.83
FIXED RATE MORTGAGE (10/7) one year	5.80	5.69	4.15

Federal Reserve, HSH Associates

1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

MANUFACTURING INVENTORIES

Oct. 17, 10 a.m. ► Inventories held by manufacturers, wholesalers, and retailers rose by about 0.4% in August, not far from their monthly increases in July. That's the median forecast by analysts surveyed by MMS International of McGraw-Hill Inc. Manufacturers already reported a 0.1% advance in their stockpiles for the month. Sales probably increased by a similar amount in August, as suggested by the pickup in factory shipments and 0.8% in retail sales. As a result, the ratio of inventories to sales likely dropped in August, from its 1.42 reading in

INTERNATIONAL TRADE

Wednesday, Oct. 19, 8:30 a.m. ► The trade deficit in goods and services likely narrowed only modestly in August, to about \$9.9 billion, from July's unexpectedly large \$11 billion total. That would place the average for the trade gap so far in the third quarter above its second-quarter pace. For merchandise alone, the MMS forecasters expect the deficit to narrow a bit more, to \$13.5 billion, from \$15.7 billion in July. Exports, which dropped by 4% in July, are projected to bounce back to a record \$42.4 billion. Imports, which were flat in July, probably dipped slightly in August as retailers worked off an overhang of inventories, including imported goods.

HOUSING STARTS

Thursday, Oct. 20, 8:30 a.m. ► The MMS survey forecasts that housing starts fell to an annual rate of 1.4 million in September, after rising 2.1% in August, to a 1.44 million pace. However, that increase was caused entirely by a 33% surge in apartment construction, a gain unlikely to be repeated. Starts of single-family homes fell in August. Higher mortgage rates are cutting some buyers out of the real estate market, leading to a slowdown in housing activity. Payrolls at general building contractors have flattened out this summer. Builders report that buyer traffic is weakening, and mortgage applications to purchase a home declined in September.

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (10/8) thous. of net tons	1,929	1,913#	6.3
AUTOS (10/8) units	131,257	119,568r#	11.1
TRUCKS (10/8) units	113,648	113,400r#	3.5
ELECTRIC POWER (10/8) millions of kilowatt-hrs.	57,232	57,941#	3.6
CRUDE-OIL REFINING (10/8) thous. of bbl./day	13,762	14,072#	-0.6
COAL (10/1) thous. of net tons	20,514#	20,007	11.6
PAPERBOARD (10/1) thous. of tons	895.6#	880.4	5.4
PAPER (10/1) thous. of tons	829.0#	829.0r	3.2
LUMBER (10/1) millions of ft.	496.8#	496.9	4.3
RAIL FREIGHT (10/1) billions of ton-miles	24.9#	24.1	10.2

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., American Forest & Paper Association, WWPAA¹, SFPAA², Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (10/12) \$/troy oz.	387.900	393.700	5.9
STEEL SCRAP (10/11) #1 heavy, \$/ton	133.50	134.50	3.5
COPPER (10/8) ¢/lb.	121.5	126.0	42.0
ALUMINUM (10/8) ¢/lb.	80.0	79.0	55.3
COTTON (10/8) strict low middling 1-1/16 in., ¢/lb.	66.26	68.85	20.3
OIL (10/11) \$/bbl.	17.71	17.96	-4.8

Sources: London Wednesday final setting, Chicago market, Metals Week, Memphis market, NYMEX

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (10/12)	99.95	99.49	107.15
GERMAN MARK (10/12)	1.54	1.54	1.62
BRITISH POUND (10/12)	1.58	1.59	1.51
FRENCH FRANC (10/12)	5.28	5.27	5.73
ITALIAN LIRA (10/12)	1568.0	1567.5	1595.5
CANADIAN DOLLAR (10/12)	1.35	1.35	1.33
MEXICAN PESO (10/12) ³	3.419	3.412	3.106

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars

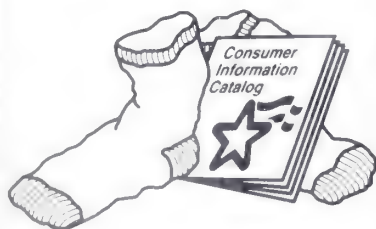
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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

Activision 8
Adolph Coors 8
AIM Aggressive Growth 110
Air France 52
AlliedSignal 71
American Airlines 8, 32, 71
American Management Systems 71
American Medical Holdings 45
Ameritech 6
Apple Computer 12, 34, 90
Archer Daniels Midland 6
AT&T 8, 18, 32, 73, 92
Avon Products 93

B

Bain 71
Bear Stearns 84
Bell Atlantic 92
Bernard Hodes Advertising 18
Birmingham Steel 80
BKP Partners 88
Blockbuster 76, 88, 110
Booz, Allen & Hamilton 71
British Airways 52
British Midland Airways 52
Brothers Gourmet Products 76
BRW Steel 80

C

Canadian Imperial Bank of Commerce 82
CBS 40
Chase Manhattan 8, 82
Cifra 93
Citibank 32, 82
Coca-Cola 8
Coffee Connection 76
Columbia/HCA Healthcare 45
Comcast 92
Compression Labs 84
CompuServe 18
Continental Cable 92
Corning 88, 110
Cox 92
Crédit Lyonnais 52
CSC Index 62
Compuware 110
Cytogen 84

D

Danzas 76
Dart Group 45
De Beers Centenary 38
Deere 6
Deloitte & Touche 6

Delphi Internet 18
Delta Air Lines 32
Diamant Boart 38
Diamond International 92H
Digital Equipment 12
Digital Express Group 18
Donaldson, Lufkin & Jenrette 6, 32
Dow Chemical 84
Dragon Fund 50
Dress Barn 110
Dunkin' Donuts 76

E

Eastman Kodak 73
Electronic Data System 71
Eli Lilly 47
EMI Music 56
Epson 12
Ernst & Young 45, 62, 71
Estée Lauder International 86

F

Fletcher Asset Management 84
Fokker 52
Ford 45, 73
Fox Broadcasting 40

G

Gap 15
GE 38, 73
Genentech 108
General Foods 76
GM 71
Gnosso Software 18
Goldman Sachs 45, 71
Goldstein Golub Kessler 84
Groupe Bull 52
GTE 92
Gulf Air 92H

H

Hambrecht & Quist 76
HarperCollins 6
HealthTrust 45
Heartland Value 110
Hewlett-Packard 12
Hongkong & Shanghai Banking 82
Hydro-Quebec 15

I

Ibbotson Associates 110
Iberia 52
IBM 8, 15, 34, 73, 90
ICL 52
In-Flight Phone 92
In Focus Systems 45
Intel 34
International Data 34
International Game Technology 88
Internet Info 90
Ispat Group 80

J

Jensen Securities 76
Jiffy Lube International 96
J.P. Morgan 26

Kemper Financial Services 26
Kidder Peabody 38, 84
Kleiner Perkins Caufield & Byers 90
Kmart 15
Korea Electric Power 50
Korea Fund 50
KPMG Peat Marwick 8

L

Lazard Frères 84
Lazer-Tron 88
LCI International 110
Lehman Brothers 32, 71
Lipton Tea 76

M

Mary Kay Cosmetics 93
Maryland National Bank 96
McCaw Cellular Communications 92
McDonald's 76, 96
McGraw-Hill 6
MCI 92
McKesson 47
McKinsey 71
Merrill Lynch 29, 50, 110
Microsoft 12, 34, 90
Mitsubishi 52
Morningstar 110
Mosaic Communications 90
Motif 45
Motorola 34, 45

N

National Medical Enterprises 45
National Semiconductor 18
NatWest Securities 88
Netcom 18
Nextel Communications 92
Nichols Institute 110
Nike 110
Norstan 110
Novell 90
Nucor 45, 80
Nynex 92

O

Olympia & York 82
Opinion Research 62
Oppenheimer Main Street Growth & Income 110

P

PBHG Growth 110
Pennzoil 96
PepsiCo 76
Peregrine Capital Management 96
Peugeot 52
Philip Morris 6, 110
Phillips-Smith Specialty Retail 76
Pohang Iron & Steel 50

Q

Quest Advisory 110
QVC 40

Ram Research 32
Renault 52
Royce OTC Fund
Ruddick Asset Management 88

S

Saatchi & Saatchi
Sabena 52
Salomon Brothers
Samsung 50
Sanford C. Bernstein
Sanwa 82
Scudder Investor Services 50
Sears 8, 15
Sega 88
Sharon Steel 80
Sibeka 38
Silicon Graphics
Southwestern Bell
Spelling Entertainment 88
Sprint 92
Spry 18, 90
Spyglass Marketing
Starbucks 76
Sun Microsystems

T

Taco Bell 76
Tele-Communications 107
Thousand Trails 76
Time Warner 40, 90
Toshiba 34
Touche Ross International 62
TWA 45
Twentieth Century Giftrust 110

U

U-Haul 45
USA Networks 118
USX 45

V

Van Kasper Adviser
Veritas Capital 80
Viacom 88
Virtual I/O 107
Vobis 34
Volvo 52

W

Wal-Mart 93
Walt Disney 32, 40
Warner Music 56
Western Digital 42
Westinghouse Broadcasting 40

X

Xerox 15

Y

Yankee Group 92
Youth Services International 96

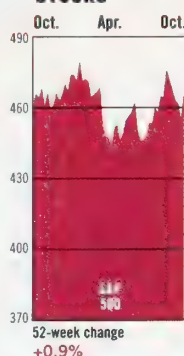
Z

Zenith Electronics
Zevenberger Capital

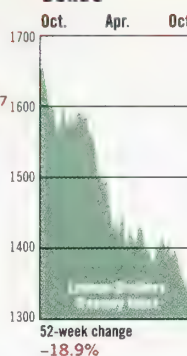
Investment Figures of the Week

MARKET
The market had a smart about-face as fears nudged the Dow points on Oct. 6. Last innocuous employment with reports of strong corporate earnings, but jitters and kicked off double-digit gains. In the party, with the 10-year Treasuries 5% on Tuesday after 1% on Friday. The rally on Wednesday, when the long bond rose to 7.89% and the Dow jumped 1.7 points.

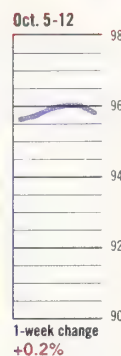
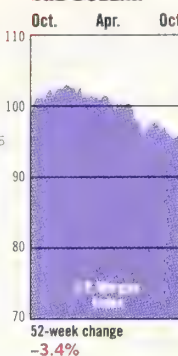
STOCKS



BONDS



THE DOLLAR



ANALYSIS

	Latest	% change Week	% change 52-week
INDUSTRIALS	3875.2	2.3	7.5
COMPANIES (S&P MidCap Index)	175.0	2.5	-0.9
COMPANIES (Russell 2000)	254.9	2.2	-1.2
COMPANIES (Russell 3000)	267.7	2.5	-0.3

	Latest	% change (local currency) Week	% change 52-week
FINANCIAL TIMES 100)	3100.5	4.9	0.6
NIKKEI INDEX)	20,089.7	1.7	0.3
COMPOSITE)	4355.0	2.4	5.9

FUNDAMENTALS

	Latest	Week Ago	Year ago
90-DAY TREASURY BILL YIELD	5.12%	5.07%	3.10%
30-YEAR TREASURY BOND YIELD	7.89%	7.95%	5.92%
S&P 500 DIVIDEND YIELD	2.75%	2.80%	2.77%
S&P 500 PRICE/EARNINGS RATIO	18.3	17.9	21.7

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 200-day moving average	460.6	460.8	Positive
Stocks above 200-day moving average	37.0%	31.0%	Positive
Speculative sentiment: Put/call ratio	0.83	0.84	Positive
Insider sentiment: Vickers sell/buy ratio	1.37	1.44	Positive

BLOOMBERG FINANCIAL MARKETS

MARKET GROUPS

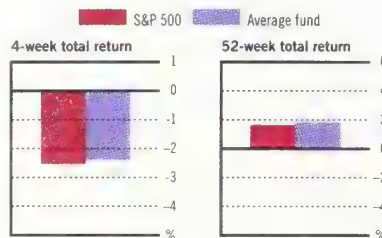
LEADERS	% change 4-week	% change 52-week	Strongest stock in group	% change 4-week	% change 52-week	Price
TECHNOLOGY	9.1	7.8	COCA-COLA	9.8	22.1	50 ³ / ₈
COMPUTER SYSTEMS	6.4	47.1	DIGITAL EQUIPMENT	21.4	-22.9	29 ¹ / ₈
	5.4	15.2	PFIZER	8.6	22.5	72 ³ / ₄
COMMUNICATIONS EQUIPMENT	5.2	17.7	CISCO SYSTEMS	10.6	18.4	28 ¹ / ₈
PHARMACEUTICALS	4.9	6.4	RITE AID	7.8	40.9	22 ³ / ₈

LAGGARDS	% change 4-week	% change 52-week	Weakest stock in group	% change 4-week	% change 52-week	Price
MINING	-11.8	-41.2	PULTE	-12.6	-46.3	21 ³ / ₄
APPAREL RETAILERS	-11.2	-17.2	TJX	-21.8	-47.6	17 ¹ / ₂
	-10.7	-26.5	USAIR GROUP	-24.5	-63.0	4 ⁵ / ₈
STRUCTURED HOUSING	-9.8	3.3	FLEETWOOD ENTERPRISES	-12.2	-0.5	23 ³ / ₈
MATERIALS	-8.2	-19.4	MASCO	-11.2	-23.6	24 ³ / ₄

MORNINGSTAR INC

FUND RETURNS

	%	LAGGARDS	%
Four-week total return		Four-week total return	
STRATEGIC INVESTMENTS	5.0	STEADMAN AMERICAN INDUSTRY	-12.2
CENTURY GIFTRUST INVESTORS	5.0	FIDELITY SELECT AIR TRANSPORTATION	-11.9
AMERICAN TECHNOLOGY A	3.9	FIDELITY SELECT CONSTRUCT. & HOUS.	-8.6
52-week total return		52-week total return	
STRATEGIC INVESTMENTS	56.6	MONITREND GOLD	-39.0
EMERGING MARKETS INSTL.	43.7	STEADMAN OCEANOGRAPHIC TECHNOLOGY	-36.5
VERY GROWTH	43.6	AMERICAN HERITAGE	-29.9



PORTFOLIOS

Portfolios represent the performance of \$10,000 invested one year ago.

Percentages indicate annualized returns.

Foreign stocks
\$11,377
+0.75%

Gold
\$10,555
-1.22%

U.S. stocks
\$10,387
+2.46%

Money market fund
\$10,207
+0.05%

Treasury bonds
\$6,887
+0.03%

DRUMMcGRAW-HILL

Data are as of market close Wednesday, Oct. 12, 1994, unless otherwise indicated. Percentages include S&P 500 companies only; performance and share prices are as of market close.

Market close Oct. 11. Mutual fund returns are as of Oct. 7. Relative portfolios are valued as of Oct. 11. A more detailed explanation of this page is available on request. NA=Not available r=revised

A BETRAYAL OF THE GOP'S PRINCIPLES

Priniples. Once upon a time, belonging to a political party meant standing by them. Take free trade. Just yesterday, "Republican Party" was synonymous with free trade. For Republicans in the House and the Senate, the issue was a no-brainer. The party, in the modern era, has always stood for free markets and competition, at home or abroad.

But no more. Principles are suddenly less important than denying a weakened President Clinton any legislative victories before November's midterm elections. That is why Senate GOP leader Robert Dole of Kansas and House Republican leader Newt Gingrich of Georgia are trashing the new General Agreement on Tariffs & Trade. They might have succeeded in killing it had the Business Roundtable not given Dole a wake-up call recently.

As it is, a final congressional vote on the trade pact won't take place until after the elections, giving Naderites, unions, and isolationists time to mobilize opposition. Worse, the GOP's new "Contract with America," signed by 316 Republicans running this fall, is mum on the subject. For the first time in memory, the party of free trade is not fighting for it.

Beneath the betrayal of principle lies the poisonous polarizing of politics that has taken hold in Washington. Dole and Gingrich sense what Ross Perot and Pat Buchanan captured in last year's fight over the North American Free Trade Agreement. Americans, anxious about the global economy, are looking for someone to blame, be they immigrants or big business. It used to be the unions and the Democrats that expressed those fears politically. Not anymore.

Free trade is always a hard sell. But as a vibrant macroeconomic force for growth and prosperity, it hasn't failed America yet. Witness what NAFTA has wrought. Instead of U.S. companies fleeing south to exploit cheap labor, exports and trade are booming. The economic impact of GATT, with tariff cuts averaging 36%, will be NAFTA multiplied by 100.

There is no retreat from the new world economy. Those who export will prosper; those who don't will suffer. Dole, Gingrich, and the Republican Party know this. Their flirtation with protectionism is shortsighted and destructive. They should return the GOP to its true free-trade bedrock.

THE RUBLE'S BRUTAL LESSON

What is one to make of the precipitous drop in the value of the Russian ruble? A one-day plunge of 27% invites images of a worthless currency, hyperinflation, and economic as well as political chaos. This was true of Germany in the 1920s. It is not true of Russia in the 1990s—not yet anyway.

The ruble crisis is a brutal reminder to Prime Minister

Viktor Chernomyrdin that, despite great success in tizing the Russian economy, there is no alternative to restraint. The markets will have their revenge.

For the first half of 1994, Chernomyrdin was able to drive the credit-hungry bureaucrats from the farming and heavy-industrial sectors. As a result, the government cut credit, the central bank printed less money, inflation was in half—to 5% a month—and the ruble stabilized. Foreign investors began pouring billions of dollars into the stock market and newly privatized Russian companies. In August, the vicious cycle ended. Political pressure pushed Chernomyrdin to the government lending once again. By September, inflation was up to 8% monthly. The ruble was ready for a fall.

What to do now? Chernomyrdin has no choice but to move to a tighter fiscal and monetary policy. Privatization is proceeding at an amazing pace in Russia and a new class of entrepreneurs is growing fast. But it will be years before state industries can be absorbed by the expanding private sector. In the interim, President Boris Yeltsin and Chernomyrdin must perform delicate economic surgery on Russia, using political and financial instruments. Hyperinflation cannot be that impossible. Witness the current panic over the ruble.

IT'S POWER, NOT THE WAY YOU TALK

The argument of Deborah Tannen's new book, *Talking From 9 to 5*, is seductive: Men and women have different talking styles. Men tend to be boastful, interrupting and commanding, always trying to "one-up" their colleagues. Women tend to be indirect, ingratiating, and hesitant, always trying to blend in and be sensitive to the group. The result? The different speech styles often lead to miscommunication between the sexes, with women suffering most of the consequences in terms of opportunities, promotions, and pay. Tannen argues that if only men and women understood one another's special styles, there would be fewer misunderstandings and women would be better able to break through the proverbial "glass ceiling."

Alas. If only it were that simple. Status and the roles people play at work have at least as much to do with their speech styles as gender and the different ways boys and girls are brought up. Does anyone really think that Linda Wachner, president of Warnaco, or Kay Koplovitz, chief executive of Networks, are hesitant or indirect in the way they talk to theirordinates? Speech styles depend in great part on the power relations between speaker and listener. That power may come from work status, social status, or age, but it is real.

This is not to deny that gender plays a role in differentiating speech styles. It's just that it doesn't play much of one. Texans and New Yorkers, Yalies and Michigan graduates, twentysomethings and aging boomers have been bringing different styles of talking to the office for years. The failure of women to get ahead in the workplace can't be rationalized by simply their style of speech. They must have equal access to networks, contacts, mentors—the stuff of power.



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*"For the past 11 years, we've only owned Chrysler vehicles."
The Staffers Family, Anchorage, Alaska*

*"My Plymouth Voyager has 186,000 miles on it...
I just bought a Dodge Caravan to keep it company."
Clarissa Avery, Bainbridge, Georgia*

*"When I say 'our' I should mention that my Dad was
so impressed with the Neon Sport that he bought one
for himself." Holly Westhoff, Columbus, Ohio*

*"My Concorde is the best driving car I have ever owned
or driven." Burke Johnson, Rouseburg, Oregon*

*"The last two cars I purchased were both European...I was pretty
much set on buying another Volvo when I decided to go take a look
at the Eagle Vision...The Eagle Vision is everything I want in a car.
I've put over 18,000 miles on it and I still think the car is fantastic."
Dean Mauteu-Laurent, Huntington Beach, California*

*"As a former Mercedes owner, the handling of the [Jeep] Grand
Cherokee was important." Michael Orlanda, San Diego, California*

*"Since 1984, I've bought 13 minivans from the Chrysler
Corporation." Orville 'Sherry' Avery, Madison, Nebraska*

*"When the car arrived, I bought it straight off the truck. Now, 1,000
miles later, I can't find anything wrong with my Eagle Vision [1.9]."
H. Stephen Crauton, San Marcos, California*

*"...I put all my trust into Dodge vehicles and
wouldn't buy anything else." Deanna Perlinger,
North Huntingdon, Pennsylvania*

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SS WEEK
OCTOBER 31

BusinessWeek

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MANAGING RISK

Derivatives can be a dangerous game — just ask the corporations that got burned in last spring's debacle. Chastened executives, convinced that managing risk is essential to survival, are now rushing to redesign their strategies for the perilous '90s. Here's how. PAGE 86

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so companies exert a powerful control

over cash flow.

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BusinessWeek

OCTOBER 31, 1994



Special Report

86 MANAGING RISK

The recent wave of financial calamities has taught any number of companies in the U.S. that only comprehensive strategies, directed from the top, will keep disaster at bay

88 THE HIGH ART OF HEDGING AT MERCK

CFO Judy Lewent's savvy moves

89 POINT MAN AT MERRILL LYNCH

Daniel Napoli's aggressive offense

90 DAMAGE CONTROL AT FMC

The simple approach to safeguards

92 MINDING THE SAFE AT BANKERS TRUST

Daniel Mudge's daily risk report

96 ROCK-SOLID AGAIN AT PRUDENTIAL?

The revamping of its risk controls

98 HEDGING COMMANDMENTS

Rules you would be smart to live by in a dangerous game

100 DEFT PLAY WITH DERIVATIVES

To cut losses on losers, investors are hanging on to them

102 MAJOR MARKET MELTDOWN?

Not likely. Why the world financial system is surprisingly secure

Top of the News

40 BLOOD ON WALL STREET

Investment banks' profits are slumping, and the pink slips are piling up

42 PROFITS: ANOTHER PRETTY PICTURE

Economists expected a slow third quarter. Boy, were they wrong

44 WHY CLINTON IS ON THE STUMP

Even a President shunned by his own party can draw big bucks

45 TARNISHED KNIGHTS OF BUSINESS

Incumbents regain ground by dredging up the records of execs-turned-pols

46 CONSECO CLOSES IN ON KEMPER

Is the suitor paying too much for a formidable corporate name?

48 HITTING BEDROCK AT DEERE

The company and labor are miles apart, and management won't budge

50 BILL GATES AT THE TELLER'S WINDOW

He's making banks nervous as Microsoft eyes personal banking

52 LOOSE LIPS AT KODAK

A leaked memo detailing spending cuts put the stock into a free fall

52 COMMENTARY

The Baby Bells' phony argument—who should pay for telecom upgrade

54 IN BUSINESS THIS WEEK

The feds and NASDAQ, Zeos, Bell's Baldrige, MCI's directory resistance, Uncola coda, Gensia, Kawasaki Se

International Business

58 JAPAN

A new wave of investment in the is gathering force

59 EUROPE

Chunnel trains may spark a bloody battle with planes and ferries

60 GERMANY

Kohl's slim majority means he may have to abandon his economic plan

64 PHILIPPINES

Reforms have busted monopolies and lured foreign investors

65 A TALK WITH FIDEL RAMOS

For the U.S., "we are the gateway to this part of the world"

68 INTERNATIONAL OUTLOOK

In the Mideast, a race to come up a peace dividend

SPECIAL REPORT

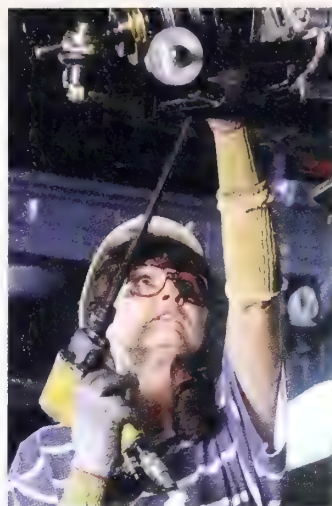
MANAGING RISK

The derivatives debacle last spring taught Corporate America some hard lessons about financial risk in the perilous '90s—and the need to control it page 86



NOTHING SACRED

With its attacks on lifetime employment and bureaucracy, Matsushita has thrown out the rule book page 108



THEY'RE BA-ACK

Japanese investors hit the U.S.—but with a difference page 58

BIOTECH BIND

Amgen's challenge: Keeping profits healthy until the next breakthrough page 122



STRONG HAND

Philippine President Ramos shakes the economy out of its slumber page 64

Economic Analysis

OPINION VIEWPOINT

Is "Social" pensions? No

OPINION TRENDS

Flows, T-bills, Mexican wages, stability

OPINION OUTLOOK

Let inflation's ghost spook you
A fiscal mess. Otherwise...

Government

WASHINGTON OUTLOOK

Mike is no sure thing

"ALTMAN"

Newman, Treasury's new No. 2,
change from Roger Altman

Education Issues

QUALITY CLASSROOMS

Schools are borrowing the
technique

Sports Business

OPINION TRENDS

Is the root of hockey's problems?
The answer is success

The Corporation

108 MATSUSHITA: TRADITION BE DAMNED

Its radical U.S.-style restructuring has
it well on the way to turnaround

112 MCA: A RIFT RUNS THROUGH IT

Studio chiefs battle with Matsushita

114 AMERICAN MAY BE TOO FIT

With the airline's profits back, labor is
balking at more sacrifices

Information Processing

24 TECHNOLOGY & YOU

Windows 95 lets users transport—and
update—files with ease

117 APPLE'S MAN IN JAPAN

Frank Sanda has the right stuff to go
up against Microsoft's Windows

118 GEOTEK: FROM MISSILES TO PHONES

Military tech for your mobile phone

Science & Technology

122 AMGEN'S BIOTECH DILEMMA

Growth vs. staying independent

127 DEVELOPMENTS TO WATCH

Electric motors, patents on line,
radiation-proof camera, bacteria

Personal Business

130 FINANCES: All-in-one accounts

SMART MONEY: Railroad stocks

SOFTWARE: CD-ROM encyclopedias

Features

6 UP FRONT

10 READERS REPORT

20 BOOKS

106 INSIDE WALL STREET

Psyched up for a hospital buyout
Chipmakers have Tencor sizzling
A hee-haw play in Vegas

139 BUSINESS WEEK INDEX

140 INDEX TO COMPANIES

141 INVESTMENT FIGURES OF THE WEEK

142 EDITORIALS

In America, IQ is not destiny
Making risk less risky

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Up Front

EDITED BY LARRY LIGHT & JULIE TILSNER

FAT WALLET

LOU GERSTNER'S BIG BLUE REWARD



CONFIDENT: Buying up stock

WALL STREET HAS BEEN KIND lately to IBM—and also to its boss, Louis Gerstner. The runup of Big Blue stock has given Gerstner some handsome paper profits since his April, 1993, arrival: \$1.1 million on the 50,000 shares he owns, plus \$13.8 million on options granted as part of his pay package.

Shortly after coming to IBM, when investors were treating its shares like toxic

waste, he began buying on the open market. And he kept that up through the stock's nadir (42 in August, 1993) and into the current upswing (75% on Oct. 19), spending \$2.6 million. Key factors in Wall Street's change of heart are Gerstner's relentless cost-cutting at the computer giant and the perception that an improving global economy bodes well for IBM earnings.

But the fact that Gerstner was putting his own money in helped. Says Smith Barney Shearson analyst Barry Bosak: "That's a real statement of confidence." The investment community also appreciated that he didn't exercise any of his options, a sign that he thought it better to wait because the stock price would go even higher. In April, 1994, he was eligible to exercise, for 44%, 25% of the options he has on 500,000 shares. Given his wealth—\$2.6 million in 1993 pay—he can afford to buy a lot. □

SUPPLY AND DEMAND

BOTTLENECK IN THE DISH BIZ

LAMENT, YOU SATELLITE-TV lovers. There's a shortage of a key part for the booming satellite dish market. The decryption module, which decodes TV signals, is in short supply because distributors underestimated demand, and a production snag developed. General Instrument, which has a monopoly on the module's descrambling chip, says it's hustling to catch up.

Equipment suppliers are steaming as they watch production lag and customers walk away. Take Uniden America, the Fort Worth subsidiary of Uniden of Japan. It's the biggest supplier of channel tuners

and says the module shortage has cost it millions in sales.

The problem is confined to the big, old C-band dishes—massive monuments that occupy a sizable chunk of the yard. Even though the new pizza-pan-size digital units are out, the market is still booming for the analog-based C-band dishes. Total authorized units installed rose 27% from January to October, to 2.1 million dishes, GI says. C-band systems cost more (top price: \$2,500 vs. \$900) but are said to have slightly better picture quality.

Peter Coy



BEAM IT DOWN: Key part missing

TALK SHOW "People don't realize we've had a crash in the bond market, worse than the stock market crash in '87."

—Donald Marron, CEO of PaineWebber, which is buying Kidder Peabody, whose fixed-income woes have been acute

SLUGFESTS

THIS PAINKILLER GIVES RIVALS A HEADACHE

FIREWORKS WERE EXPECTED when Procter & Gamble's new Aleve muscled into the \$2.6 billion painkiller market. No one was disappointed. Aleve, an over-the-counter version of prescription drug Anaprox, was rolled out in

More surprising than Aleve's sudden ascension is preliminary evidence suggesting that its inroads are not necessarily at rivals' expense. For one thing, Aleve has attracted patients who used the prescription drug

For another, Procter's marketing blitz and a counterattack from competitors have hiked overall pain-reliever sales. Says Paul Kelly, Silvermine Consulting Group's Johnson & Johnson's Tylenol brand is launched as "Extended

TOP BRAND-NAME PAIN RELIEVERS



June with TV ads

claiming it lasts longer than market leader Tylenol and, by implication, other remedies. Since its debut, according to independent data made public by P&G, Aleve had powered into a tie with Excedrin for third place among brand names (chart).

lief" version.

Other reaction to Aleve's harsher. Maker of No. 2 Advil, American Home Products has filed a suit accusing P&G of false claims. A U.S. District Court hearing began Oct. 7. P&G brushes aside AHP's complaint. Zachary Schiller

RETAIL REVELRY

LEVI'S WANTS TO HANG OUT AT THE MALL

IT'S NOT HARD TO FIND A store that sells Levi's. Turns out, though, the jeans wholesaler is opening its own nationwide retail chain. Within five years, Levi Strauss plans to have 103 denim-oriented Original Levi's stores, 47 casual-clothes Dockers Shops, and 90 factory outlets. One hurdle: It needs flexibility from the feds on a 1978 consent decree barring it from controlling retail prices. Levi's expects an O.K. soon.

Why this move? "To enhance brand image," says Robert Rockey, a top Levi's exec. Levi's basic business is struggling. Revenues this year are expected to be flat at about \$5.9 billion, with earn-



HIP SHOT: Gunning for Gap

ings below 1993's \$492 million. For now, Levi's big customers say its new stores won't steal sales. But at 800-store Sears, head of apparel Robert Miller says, "If they open lots of these, that becomes competition." One target is clear: Levi's. Says Rockey: "We have to compete head-to-head" with Gap. Russell Mitchell

IT IS THE ROOTS OF A STRUCTURE
THAT CONTINUE TO PROVIDE
ITS STRENGTH AND STABILITY.



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NEW WORLD ORDER

A TIMEPIECE FOR THE NUCLEAR WINTER

SOVIET NUCLEAR MISSILES may no longer be the threat they were during the cold war, but the clock is still ticking. And a San Diego businessman wants to sell it to you. Mike Rivkin of Sunset Cliffs Merchandising is selling "doomsday clocks"—timepieces originally designed for use in launching Soviet missiles.



WELL-BUILT: Soviet clock

These clocks, he says, can take a licking and then some. Built to last 500 years, they can withstand 10g's of pressure and temperatures ranging from -76F to

140F. Owners, though, wind them periodically, the old-fashioned way. They run mechanically, so they're immune from the electromagnetic fields created by a nuclear attack.

A doomsday clock, which comes complete with inspection documents, goes for \$699. Rivkin has sold about 50 and has 100 left. He's also hawking other Soviet military clocks: for MiG-29 fighter planes (\$249), Soviet missile submarines (\$229), T-72 tanks (\$120), and the

Soyuz spacecraft (\$799). The clocks, says Rivkin, "are beautifully made, with wonderful workmanship."

Rivkin, a former commercial fisherman, is one of several American entrepreneurs now trafficking in Soviet military gear, obtained from Russian factories eager to cash in on the peace dividend. He started out in 1991, peddling 95 pairs of Zeiss-Jena binoculars used by East German border guards in the bad old days.

Scott LaFee

DRAWN & QUARTERED



AD GAMES

THE WRITING ON THE BATHROOM WALL

TALK ABOUT YOUR CAPTIVE audience. Marketing mavens are now placing ads on restaurant restroom walls. It's mainly upscale goods, such as Cadillacs or Rolexes, from local stores looking for cheap space. In Pittsburgh, that runs \$20 to \$30 monthly for an ad. Restroom ads also are cropping up in Atlanta, Chicago, and Miami.

This niche is the province of small regional advertising firms, not Madison Avenue giants. Advantage Indoor Advertising, for instance, has

placed ads in 50 Pittsburgh eating establishments. Client gets ads with a plastic protective covering, posted at level above the urinals in men's rooms and on side doors in ladies' rooms. "People can't miss them," says Advantage President D. Law Stokes.

Bathroom advertising

works best when the merchandise is within walking distance of the short car ride from the

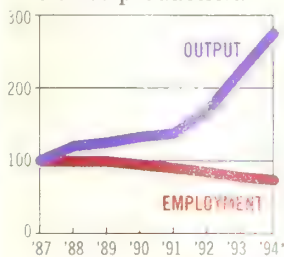


says Gary Stibel, founder of New England Consulting Westport (Conn.) market adviser. When there's no advertisement in place, Advantage posts a sign saying: "Customers will be relieved to your ad." *Keith L. Alexander*

THE BIG PICTURE

PRODUCTION UP, NOSE COUNT DOWN

Many producers of computing and office equipment have slashed their payrolls in recent years. But the cutbacks haven't slowed production.



▲ INDEX: 1987 = 100 * JAN-AUG AVG
DATA: FEDERAL RESERVE, LABOR DEPT., BUSINESS WEEK

GLOBAL TRADE

WHY FIDEL IS HUMMING 'O CANADA'

WITH U.S. COMPANIES STILL barred from doing business in Cuba, Canadians are rushing in to exploit opportunities created by Fidel Castro's economic liberalization. There are now about 20 joint ventures between Canadian outfits and state-controlled Cuban companies, up from 2 in 1992. And an additional 18 deals are under review.

Most of them focus on developing Cuba's considerable mineral resources. In June, Canada's Sherritt reached a

sweeping deal with Cuba's General Nickel to mine and refine the island's rich nickel reserves, which are among the world's largest. Canada Northwest Energy, a Sherritt subsidiary, has struck oil in wa-

CANADA'S CUBAN CONNECTIONS

CANADA NORTHWEST ENERGY
Offshore oil drilling

DELTA HOTELS & RESORTS
Managing nine hotels

MACDONALD MINES
Gold exploration

SHERITT Nickel mining, refining

ters off Cuba, and it appears that it has found a significant deposit. And at least six Canadian mining companies are now looking for gold in Cuba using new gold-recovery technology.

Then comes tourism. Delta Hotels & Resorts, which is often described as "Canada's Marriott," is targeting

100,000-plus Canadian tourists who vacation on the island every year, more than from any other country. By December 1, Delta will have taken over management of nine different properties in Cuba, with a total of 800 rooms—and the company is planning to expand that to 1,200 rooms next year. *William C. Symon*

What You Have The Least Of, We'll Help You Make The Most Of. Time.

It seems as if there's never enough of it. And we realize the last thing you can afford to do is run out of it. So to help you make the most of it, Delta Air Lines has a flight leaving every 17 seconds of every day to almost anywhere in the world your business might take you. To London, Frankfurt, Paris, Rome. To Tokyo, Hong Kong, Bangkok, Seoul. And every step of the way, we'll do everything possible to make sure you not only arrive relaxed and refreshed, but also with plenty of time to spare. Join us on your next business trip. We think you'll love the way we fly.



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RON BROWN RESPONDS
TO OUR POLL ON BILL CLINTON

"Probusiness Democrats" is the phrase I hear from top CEOs for the Clinton Administration's new economic approach. Certainly, it captures the successful partnership between business and government more accurately than is indicated by BUSINESS WEEK's recent corporate-leader poll ("Why business hates Clinton," Top of the News, Oct. 10).

Let's look at the bottom line. President Clinton's \$700 billion deficit reduction has restrained interest rates while keeping inflation under control. He has streamlined the public sector, even as the private economy has grown. And he has presided over the creation of 4 million new private-sector jobs, a pace that has exceeded our own early expectations.

Business has responded by devoting a postwar record share of gross domestic product to expenditures on new plant and equipment. Simply put, we have given the signals and created the tools that make it profitable for business to create wealth. As a result,

we are enjoying investment-driven, productivity-led growth. The partnership between the public and private sectors is working and working well.

This means we've moved beyond the sterile debate between the "laissez-faire" and "industrial policy" camps that preoccupied us as we lost ground in an increasingly competitive global economy. This Administration recognizes that the private sector is the engine of growth. Productivity in the Clinton Expansion has accounted for a record share of growth in output—and is laying the groundwork for rebuilding America's future. The innovative partnership created over the past two years has facilitated U.S. competitiveness at home and abroad, now and in the long term.



IN DEFENSE OF CLINTON

"The President has kept inflation under control, streamlined the public sector, and presided over the creation of 4 million private-sector jobs."

—Commerce Secretary Ron Brown

mercial diplomacy. On missions I have led, from China to South America to the Middle East to Russia to South Africa to Central Europe, the resulting successes in projects and dollars will support hundreds of thousands of U.S. jobs now and in the future. By opening markets and lowering barriers abroad, NAFTA and GATT will provide thousands more.

But just as our companies are reengineering in response to exploding technology and global competition, we need to respond to the changing needs of our families and communities. Opportunities abound at both work and school. Reforming health care and pensions and training for the skills of the future are some of the essential elements in creating a prosperous tomorrow. Our peo-

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Next
Rest Stop
40 Miles

"I HAD A TOUGH TIME GOING THE DISTANCE."

Every time I traveled someplace, I was worried about finding a bathroom so I could urinate. It was frustrating.

I saw my doctor, and he told me I was having the symptoms of a prostate condition called BPH. He prescribed **HYTRIN**. And guess what?

HYTRIN[®] HELPED

HYTRIN is a medication that can improve the symptoms of BPH (benign prostatic hyperplasia), which is an enlargement of the prostate gland. HYTRIN can help in as little as *2 to 4 weeks*. And it only has to be taken once a day.

Are you a man over 50 with urinary discomforts? Do you urinate often during the day or night? Is your urine stream difficult to start? Is it weak or interrupted? Does your bladder feel as if it isn't emptying completely?

If so, see your doctor. Your doctor can determine whether you have symptomatic BPH (or other conditions such as prostate cancer). Your doctor can also explain the different treatment options for symptomatic BPH: surgery; "watchful waiting," which consists of having regular checkups over time; and oral medications such as HYTRIN.

HYTRIN can cause a sudden drop in blood pressure at the beginning of treatment (or if you miss doses and then start taking the medication again). You may feel dizzy, faint, or "light-headed," particularly after getting up from a chair or bed.

Talk with your doctor today and call to receive your **FREE** informative booklet on symptomatic BPH and HYTRIN.

1-800-477-7778

ASK YOUR DOCTOR TODAY ABOUT

HYTRIN[®]
(terazosin HCl)

IT CAN HELP IN A MATTER OF WEEKS

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409-501-3757C

Please see patient
information on adjacent page

HYTRIN[®]

(terazosin HCl)

PATIENT INFORMATION ABOUT HYTRIN[®] (HI-TRIN)

Generic Name:
terazosin (ter-A-zo-sin)
hydrochloride

When used to treat
BENIGN PROSTATIC
HYPERPLASIA (BPH)

Please read this leaflet before you start taking HYTRIN. Also, read it each time you get a new prescription. This information should NOT take the place of a full discussion with your doctor. You and your doctor should discuss HYTRIN and your condition before you start taking it and at your regular check-ups. HYTRIN is used to treat benign prostatic hyperplasia or BPH. HYTRIN is also used to treat high blood pressure (hypertension). This leaflet describes HYTRIN only as a treatment for BPH.

What is BPH?

The prostate is a gland located below the bladder. It surrounds the urethra (you-REETH-rah), which is a tube that drains urine from the bladder. BPH is an enlargement of the prostate gland. The symptoms of BPH, however, can be caused by an increase in the tightness of muscles in the prostate. If the muscles inside the prostate tighten, they can squeeze the urethra and slow the flow of urine. This can lead to symptoms such as:

- a weak or interrupted stream when urinating
- a feeling that you cannot empty your bladder completely
- a feeling of delay when you start to urinate
- a need to urinate often, especially at night, or
- a feeling that you must urinate right away.

Treatment options for BPH

There are three main treatment options for BPH:

- **Prostatectomy or monitoring or "Watchful Waiting"** Some men have an enlarged prostate gland, but no symptoms, or symptoms that are not bothersome. If this applies, you and your doctor may decide on a program of monitoring including regular check-ups, instead of medication or surgery.
- **Medication.** There are different kinds of medication used to treat BPH. Your doctor has prescribed HYTRIN for you. See "What HYTRIN does" below.
- **Surgery.** Some patients may need surgery. Your doctor can describe several different surgical procedures to treat BPH. Which procedure is best depends on your symptoms and medical condition.

What HYTRIN does

HYTRIN relaxes the tightness of a certain type of muscle in the prostate and at the opening of the bladder. This may increase the rate of urine flow and/or decrease the symptoms you are having.

- HYTRIN helps relieve the symptoms of BPH. It does NOT change the size of the prostate, which may continue to grow. However, a larger prostate

- does not necessarily cause more or worse symptoms.
- If HYTRIN is helping you, you should notice an effect on your particular symptoms in 2 to 4 weeks of starting to take the medication.
- Even though you take HYTRIN and it may help you, HYTRIN may not prevent the need for surgery in the future.

What you should know while taking HYTRIN for BPH

WARNINGS

HYTRIN Can Cause A Sudden Drop in Blood Pressure After the VERY FIRST DOSE. You may feel dizzy, faint, or "light-headed" particularly after you get up from bed or from a chair. This is more likely to occur after you've taken the first few doses, but can occur at any time while you are taking the drug. It can also occur if you stop taking the drug and then re-start treatment.

Because of this effect, your doctor may have told you to take HYTRIN at bedtime. If you take HYTRIN at bedtime but need to get up from bed to go to the bathroom, get up slowly and cautiously until you are sure how the medicine affects you. It is also important to get up slowly from a chair or bed at any time until you learn how you react to HYTRIN. You should not drive or do any hazardous tasks until you are used to the effects of the medication. If you begin to feel dizzy, sit or lie down until you feel better.

- You will start with a 1 mg dose of HYTRIN. Then the dose will be increased as your body gets used to the effect of the medication.
- Other side effects you could have while taking HYTRIN include drowsiness, blurred or hazy vision, nausea, or "puffiness" of the feet or hands. Discuss any unexpected effects you notice with your doctor.

Other important facts

- You should see an effect on your symptoms in 2 to 4 weeks. So, you will need to continue seeing your doctor to check your progress regarding your BPH and to monitor your blood pressure in addition to your other regular check-ups.
- Your doctor has prescribed HYTRIN for your BPH and not for prostate cancer. However, a man can have BPH and prostate cancer at the same time. Doctors usually recommend that men be checked for prostate cancer once a year when they turn 50 (or 40 if a family member has had prostate cancer). These checks should continue even if you are taking HYTRIN. HYTRIN is not a treatment for prostate cancer.
- About Prostate Specific Antigen (PSA). Your doctor may have done a blood test called PSA. Your doctor is aware that HYTRIN does not affect PSA levels. You may want to ask your doctor more about this if you have had a PSA test done.

How to take HYTRIN

Follow your doctor's instructions about how to take HYTRIN. You must take it every day at the dose prescribed. Talk with your doctor if you don't take it for a few days, you may have to restart it at a 1 mg dose and be cautious about possible dizziness. Do not share HYTRIN with anyone else; it was prescribed only for you.

Keep HYTRIN and all medicines out of the reach of children.

FOR MORE INFORMATION ABOUT HYTRIN AND BPH, TALK WITH YOUR DOCTOR, NURSE, PHARMACIST OR OTHER HEALTH CARE PROVIDER.

Ref. 03-4458-R1-Revised Sept., 1993

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Readers Report

ple—as well as our businesses—and deserve new tools for ensuring competitiveness.

We proudly contrast our approach with the myopic tax giveaways and ket regulatory dispensations of the recent past. Remnants of that discredited strategy have resurfaced in the Republican congressional leadership's "tract with America," creating dubious short-term gains and immense long-term costs. A contract on America more like it.

America is challenged by many forces of change—and opportunity. To ensure growth, the partnership envisioned by Clinton is essential. For those in the business community not yet on board, the message is clear: There's no time to waste. We're in this transition together, and the Clinton economic-growth partnership works.

Ronald H. B.
Commerce Secretary
Washington

It is not surprising President Clinton received weak marks from America's business leaders in your poll. After all, he has raised their personal income taxes.

I suspect that, by 1996, these business leaders will have gotten over their front to their personal wealth and will be supporting Clinton for reelection based on the solid job he is doing in restoring the economy as a strong long-term competitor in the world market.

Don Bardon
Boea Raton,

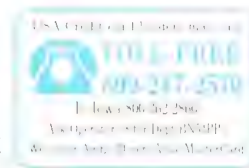
MUTUAL FUNDS: NOT SO SQUEAKY CLEAN

You say Jeffrey N. Vinik had "private meetings" with Motorola Inc.'s top executives in which they discussed Motorola's businesses ("Inside Fidelity," *Crain's Chicago Business*, Oct. 10). Both Motorola and Fidelity Investments "swear that no information was revealed beyond what is normally available to all investors. If this is the case, why does Vinik waste time and money going to Schaumburg, Ill.? This is just an example of how supposedly squeaky-clean mutual-fund business is a haven for inside deals and inside information.

Walter Livingston
Highland Park

SHOULD THE FCC BE MAKING SOCIAL POLICY?

Your story on personal communications systems (PCS) ignores the impact of the Federal Communications Commission's





Ibée

"Sentimentality is not something you expect in a financial controller. Yet whenever I see our corporate logo, I feel it's welcoming me into the family. It's based on an old Greek sculpture and perhaps that makes it special to

me. We Greeks really value that good old family. At other multinationals I worked for, headquarters seemed very distant. As if all they were interested in were my balance sheets. At Akzo Nobel I feel I

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Maria Kaffa, Controller of Organon and Organon Teknika, Greece:

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d to have my say and not just about money
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cial element in creating the right chemistry."

CREATING THE RIGHT CHEMISTRY



AKZO NOBEL

THE JOY OF SPENDING

After reading "The GOP's campaign pledge: Bad math, smart politics" (Government, Oct. 10), I finally understand why I am in such financial straits: I make too much and don't spend enough. As soon as I find my charge cards, I am going to have a fun day.

Joseph A. Moyzis Jr.
Kettering, Ohio

BASEBALL: A FEW MODEST PROPOSALS

Gary S. Becker's presentation of a fiscal solution seems ironic, coming from an economist who often mocks government intervention—preferring market solutions ("Baseball: How to level the playing field," Economic Viewpoint, Oct. 10).

Becker expresses a concern shared by many: that players' high salaries may price poorly performing, low-net-revenue teams out of the market. He acknowledges a need for spending limits to keep teams from buying their way to the pennant.

So why should government intervene to prop up poorly performing, inefficient ball clubs? Why not simply let them fail?

The geographical distribution of our nation's baseball teams represents an economic period that exhausted itself long ago. Inevitable change has transformed the nation, giving prominence to Phoenix, Tampa, St. Petersburg—and even Mexico City. Should these cities be denied access to sport franchises solely due to their ill-timed entrance into the world of prosperity?

There is no reason we can't accept the bankruptcy of a team such as the Cleveland Indians and its reemergence in a place such as St. Petersburg or Mexico City. Perhaps this is the only solution to the financial debacle facing our national pastime.

James Sanford
New York

I would like to think there are alternatives for sports fans—which is proving to be the case. When the fans stop attending the games, the greed will stop as well. When television money dries up and fan support diminishes, so will the salaries and egos of our entertainment prima donnas. As always, supply and demand is the immutable law.

Craig S. Wilson
Schaumburg, Ill.

Gary Becker's proposal for "tax" major league baseball's bottom-drawers misses the strike zone by a margin. It does nothing to motivate the players, and it hurts the teams least likely to afford it. More to the point would be to drop each year's last-place teams to the Triple-A leagues, while bringing the top Triple-A teams up to the majors. Maybe the Chicago Cubs would get motivated to win a pennant.

Steve Rh
Shorashim, Is

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Foreword by Lee Iacocca

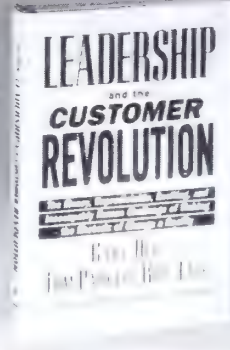
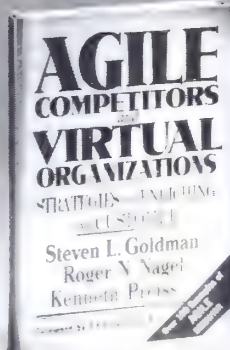
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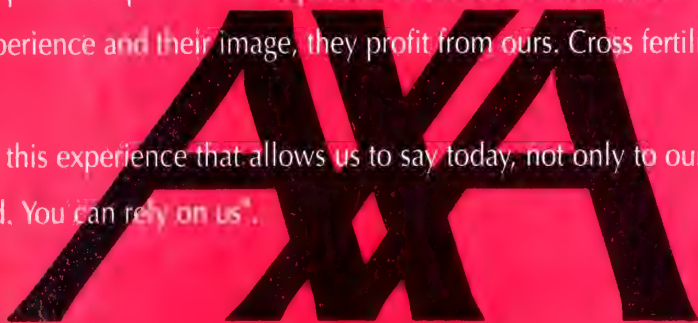
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INSURANCE & INVESTMENT

THE MONKEY WARS

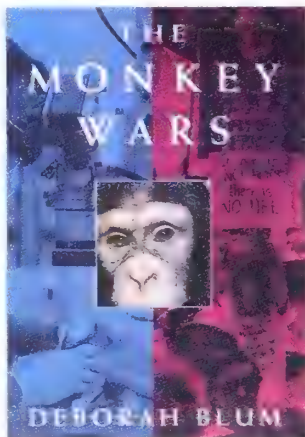
By Deborah Blum
Oxford • 306pp • \$25

PRIMATE RESEARCH: HOW MUCH GAIN FOR THE PAIN?

In the mid-1950s, medical science made a dramatic breakthrough: the creation of a vaccine to prevent polio. Within a few years, the incidence of the crippling disease plummeted from 20,000 cases per year in the U.S. alone to a mere trickle. But the victory took a heavy toll on one of humanity's animal cousins. An estimated 1 million to 5 million monkeys were killed, their cells and bodies used to grow and test the experimental vaccines.

Scientists—and most other people—see that as a price worth paying. “Is my son’s life worth more than that of a monkey?,” asks neurosurgeon Stuart Zola-Morgan of the University of California at San Diego in Deborah Blum’s book, *The Monkey Wars*. “I don’t even have to think about that answer.”

Yet many other questions about the value of primate research aren’t so easily resolved. In her book, which developed from a Pulitzer Prize-winning series in *The Sacramento Bee*, science writer Blum describes how the vanquishing of polio, along with the thalidomide disaster—where monkey tests that would have spotted the terrible birth defects weren’t done—led scientists to conclude that primates are essential to biomedical research. But in the explosion of studies since, thousands of macaques, chimps, and other primates have been subjected to experiments in which the scientific gain seems small compared with the animals’ pain. Blum provides chilling tales of pistons slamming into baboon heads to study brain trauma, for instance, and of monkeys thrown into a “pit of despair” to prove that total isolation can kill the will to live.



Add to that the gruesome conditions under which some of these animals were kept, and it’s no surprise that primate research is the front line of a bitter battle between scientists and animal-rights activists. Depending on your point of view, Blum writes, the combatants are either “us,” the defenders of modern medicine, versus “them,” the forces of ignorance and darkness” or “us,” defenders of innocent creatures, versus “them,” the heartless, sadistic butchers.”

In Blum’s mostly even-handed, deeply thought-provoking report from the war zone, the truth lies somewhere in the middle, and there’s plenty of blame on both sides. Until recently, the biomedical research community fiercely resisted acknowledging or correcting its often inhumane practices. Activists, on the other hand, sometimes appear more interested in swaying public opinion than in the welfare of individual animals. What’s more, Blum points out, the “activists rarely give fair credit to the researcher who works quietly within the system” to make conditions for research animals better, “even though many have brought about real change in the country’s laboratories.”

Indeed, if there are heroes in the book, they are the veterinarians and scientists who have improved the lot of lab primates. In many primate centers, animals are now housed in groups instead of in isolation, provided with toys, even trained to supply urine samples or proffer arms for blood drawings instead of being anesthetized.

At the same time, new science has made the questions even tougher. Blum spins an amusing yarn of how research-

ers learned—much to their surprise—that rhesus monkeys are whizzes at video games and are capable of far more complicated reasoning than any thought. “Every demonstration of animal intelligence emphasizes the point we are not experimenting on unthinking creatures,” she writes.

In a slightly disorganized fashion, Blum also delves into important issues rarely discussed in the animal-rights debate. She points out, for example, that monkeys and other primates harbor dozens of viruses, some lethal to people. That raises the specter of the use of animals in labs or as organ donors for humans unwittingly triggering a devastating epidemic. In fact, it almost happened in the victory over polio. Scientists later discovered that the monkey cells used to grow vaccines were infected with a virus so deadly that it kills more than two-thirds of humans who are infected. Fortunately, however, the vaccines had been treated with a chemical that killed the virus. The justification for using primates, Blum notes, is “to halt and prevent human illness [But] all the time, when we bring monkeys out of the rain forest, we are bringing their diseases with them and exposing people here.”

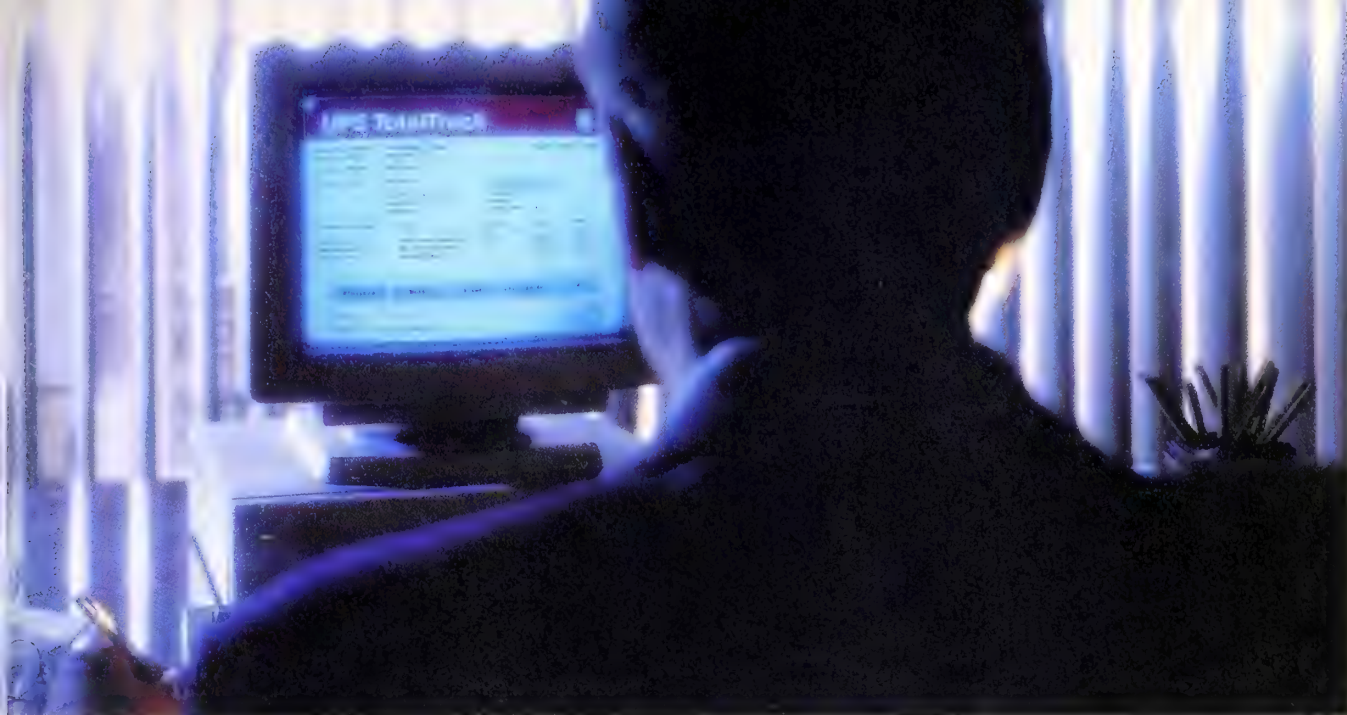
Blum occasionally stretches the fact to bash the scientific community a little more than it deserves. In the tone-setting first chapter, she describes how a chimp researcher, Roger Fouts, became a scientific outcast and lost his government grants after he sided with animal welfare groups against his colleagues. “He made a big mistake, for a researcher. He fell in love with the animals’ studies,” she writes melodramatically. In fact, Fouts had lost his funding long before he began to criticize his fellow scientists.

The rest of Blum’s book, however, firmly grounded in exhaustive reporting, giving readers the chance to come to their own conclusions after hearing from scores of scientists and activists. I guarantee that, whatever your current beliefs may be, *The Monkey Wars* will make you see the whole question of animal research—and much that has been done in the name of science—quite differently.

BY JOHN CARROLL

Senior Correspondent Carey McWilliams reports on biomedical research from Washington.

BLUM’S STUDY HEIGHTENS THE PARADOX LINKING DEATH INSIDE THE LAB AND LIFE WITHOUT



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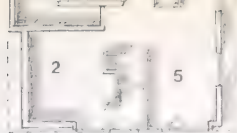
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EDITED BY STEPHEN H. WILDSTROM

WORK ON THE FLY GETS SMOOTHER

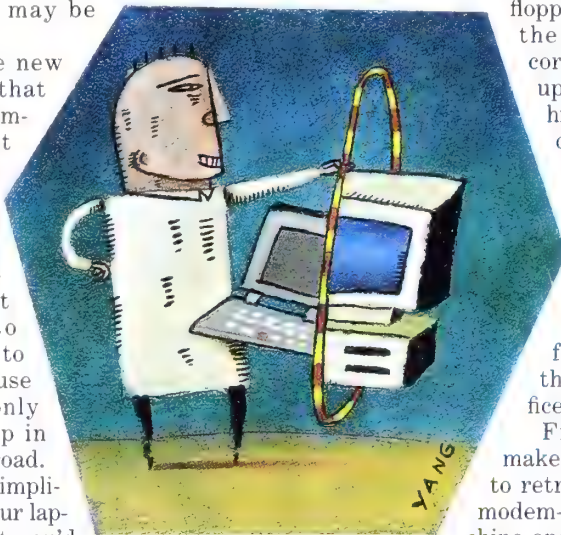
Those of us who split our computing time among the office, home, and the road have a big problem. Somehow the one file you really need always seems to be somewhere other than on the computer you're using at the moment. And often there's no easy way to retrieve it. But life may be about to get easier.

Windows 95, the new operating system that Microsoft Corp. promises to ship next spring, recognizes the new reality that your office is wherever you happen to be. New features will make it much simpler to switch from laptop to desktop machines, use a laptop as your only computer, and keep in touch while on the road.

TRICKY. You might simplify things by using your laptop all the time. But you'd be stuck with tiny displays and a cramped keyboard. Sure, a number of computer makers offer "docking stations" equipped with full-size keyboards and monitors. Plug in your laptop and you have a functional desktop computer linked to the office network and printers. The docking stations haven't become very popular, however. With current software, laptops can't automatically adjust to the new display or peripherals, and making the adjustment can be tricky. More than once I've ended up with a machine that wouldn't boot up.

When using hardware that complies with the "plug-and-play" standard drawn up by

Microsoft, Intel Corp., and other manufacturers, computers running Windows 95 should configure themselves on the fly. If you yank a laptop like the plug-and-play-equipped Compaq LTE Elite out of its docking station, it should immediately sense which displays, disk drives,



and other accessories are no longer attached. If you try to send a job to a printer while detached, the computer should automatically save it and spit it out the next time you plug in.

There's nothing new about most of this: Macintoshes configure themselves automatically, and the PowerBook DuoDock provides many of the features that will appear in the Windows 95 docking stations. But Macs need only accommodate a narrow range of mostly Apple Computer-made hardware, while Microsoft and the plug-and-play consortium have to handle dozens of manufacturers' gear.

Windows 95 will also sim-

plify things for those who use different computers in different locations. If I want to keep my phone list current on all the computers I use, I must manually copy the file onto a floppy disk and transfer the latest version from computer to computer. The new operating system lets you put the files you move frequently into a special folder called a "briefcase."

SYNCHRONIZING. Let's say you want to make sure your phone list and a key spreadsheet are always the same on your office and home computers. You would simply copy the files from your office machine onto a briefcase on a floppy. At home you open the briefcase and the corresponding files are updated—along with a hidden running record of the updates. When you're done working at home, you open the briefcase again and the new versions are copied onto it, then automatically transferred when you pop the disk into your office computer.

Finally, Windows 95 makes it possible for you to retrieve files from your modem-equipped office machine and dial into the office network. Programs such as Symantec Corp.'s PCAnywhere or Microcom Software Division's Carbon Copy provide similar capabilities. But in the new Windows they will be built-in, and will provide easier access to the network. This convenience is a mixed blessing, since any dial-in network access can create security problems. Fortunately, the software allows network administrators to disable or limit remote log-ins.

Neither doing business on the run nor using a home PC to stretch your workday to 20 hours will ever be much fun. But the next generation of software should at least ease the pain. S.W.

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Looking for evidence that serious color printing is now in the office mainstream? Laser printer king Hewlett-Packard (800 227-8164) has jumped into the fray with the new Color LaserJet. The base list price



is \$7,295, and the price tag will probably hit \$9,000 for unit set up for network use.

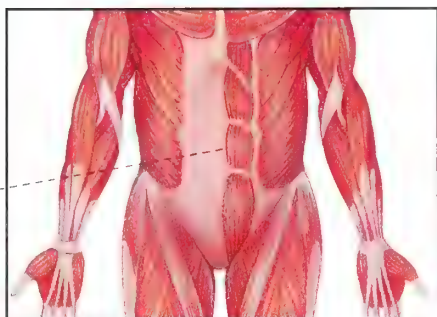
The Color LaserJet's color print quality is a bit grainy, and the matte colors seem less brilliant than the glossier output of high-end machines from QMS Inc. and Tektronix. But HP produces text with the crispness users expect from black-and-white laser printers at speeds of up to 10 pages per minute. The laser is also a disadvantage when printing transparencies. Because the plastic toner is somewhat opaque, color slides are not clear and crisp as those produced either by lower-end inkjet printers or more expensive wax-transfer units.

SOFTWARE

AN AFFORDABLE NETWORK

Users of IBM's OS/2 operating system will soon have a cheap and simple way to link their personal computers into networks. Artisoft (800 233-5566) will have an OS/2 version of its Lantastic networking system on the market by the end of the year. Lantastic for OS/2 costs \$139, with volume discounts available.

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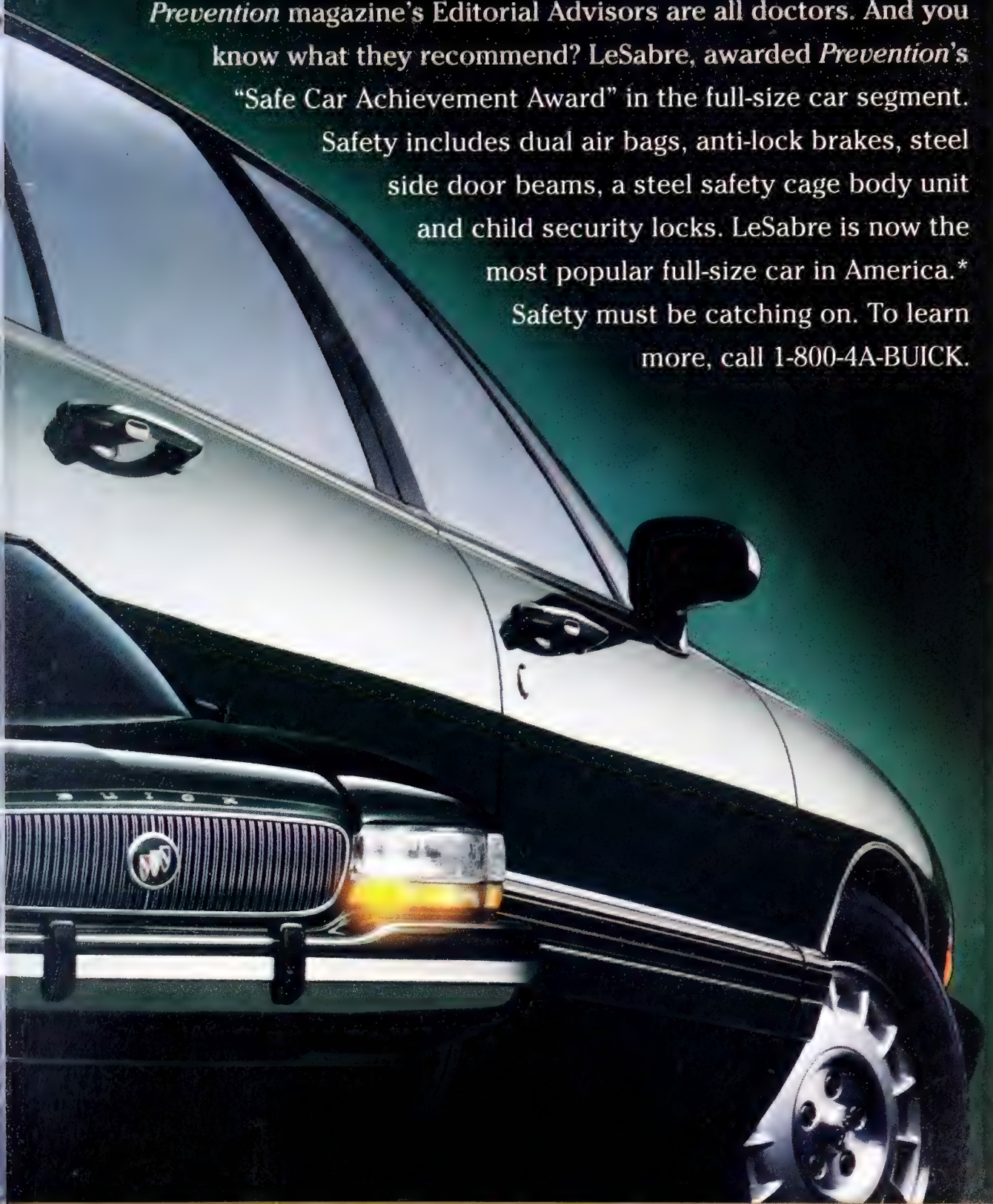
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to Uncle
Sam's hands

Having reneged on his campaign promise of a middle-class tax cut, President Clinton is now maneuvering to commandeer a portion of our pensions. If the Administration's success in getting its hooks into the assets of the banking system is a sign of the likely outcome ("Holding banks hostage is a rotten way to battle bias" *Economic Viewpoint*, Oct. 3), expect your pension nest egg to shrivel.

President Clinton installed Alicia H. Munnell, a vociferous advocate of pension taxation, as Assistant Treasury Secretary for Economic Policy. She wants to invest pension funds in public infrastructure and public education to "increase the resources available for future generations." To achieve her goal, she devised a plan that requires taxpayers to report as taxable income the contributions that they and their employers make to pension plans, along with the earnings on the pension investments known as the "inside buildup." To make up for not taxing pensions in the past, she wants to confiscate 15% of all pension fund assets.

Munnell's plan was too much even for zealous income redistributionists among Democrats on the Hill. When details of her proposal leaked out, it was quietly shelved.

SLICK MOVE. Desperate for money, Clinton has revived the redistribution goal of Munnell's pension tax, although in a different wrapper. The means: subversion of the Employee Retirement Income Security Act (ERISA), which requires that pension funds be invested solely in the interest of participants and beneficiaries. Labor Secretary Robert B. Reich has issued new interpretive regulations that permit pension fund managers to siphon our pension funds into so-called economically targeted investments (ETIs). ETIs are socially useful public projects that are deemed by the Secretaries of Housing & Urban Development and Labor to yield collateral benefits over and above the private welfare of the pension fund owner.

A "socially useful" investment with "collateral benefits" defined by public officials is also, of course, a politically useful investment—such as public housing. The Administration plans first to divert some share of our pensions into the financing of public housing and go on from there.

With ERISA subverted, the scheme's next step is to amend the Community Reinvest-

ment Act (CRA) so that its expansively interpreted "fairness" requirements can be applied to pension and mutual funds—indeed, to all financial institutions. The CRA, as originally construed, requires banks to service the communities from which they collect deposits. The act is now used to enforce racial quotas in lending, often at below-market interest rates to favored minorities.

Flocks of federal financial regulators are lobbying for CRA authority over their domains, with support from the Treasury Dept. and the American Bankers Assn. Treasury Under Secretary for Domestic Finance Frank N. Newman wants a percentage of mutual-fund assets invested in community projects, and the ABA, whose members are being forced into risky loans and an unlevel playing field, wants company for its members' misery.

HANDSOME TAKE. When left-wingers realized that taxpayer revolt limited the monies that they could squeeze out of the tax system for their redistributionist schemes, they set their sights on the stocks of assets held by pension funds, banks, and insurance companies. As the assets of the pension funds and the banking system total some \$7 trillion, "fairness" requirements on its allocation would put enormous sums of money at the government's discretion. With blacks and Hispanics comprising about 20% of the population, the government can claim allocation powers over \$1.4 trillion. If white women—also a protected minority—are included, the government can widen its fairness net over the stock of pension and bank assets to 60%, or \$4.2 trillion.

Senator Barbara Boxer (D-Calif.) supports Clinton's plan to grab our pensions. She disingenuously claims pension investments in ETIs will earn returns competitive with investments in profit-making private companies. If this were true, the Kansas Public Employee Retirement System would not have had to write off \$200 million in failed ETI investments in public housing, and Clinton would not be maneuvering to establish allocatory powers over the assets of the financial system.

In an irony of fate, the week that Reich threw our ERISA protections to the wind, Superior Court Judge Steffen W. Graae ordered Mayor Sharon Pratt Kelly to surrender the District of Columbia's public housing to an outside receiver. If the Clintonistas get their way, a big chunk of our pension assets could be headed in the same direction.

Paul Roberts is John M. Olin Fellow of the Institute for Political Economy and Distinguished Fellow of the Institute in Washington, D.C.

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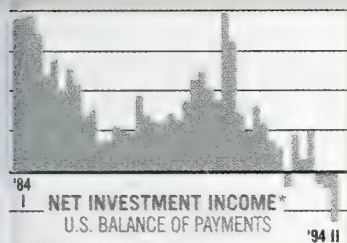
THE DOLLAR IS LOSING A FRIEND

Foreign income wanes

metime within the next year, America's ballooning trade deficit would start shrinking again as the gloom-hype overseas demand for products and a slowing U.S. economy tempers American appetites for foreign goods. But the beneficial impact is turnaround, warns economist Mil Moran of Daiwa Securities America, will be undercut by a new development on the financial front—a shift in investment income flows in favor of foreign investors.

For many decades, notes Moran, Americans have invested more overseas and earned more on such investments than foreign investors have earned in U.S. And although this investment

U.S. GLOBAL INCOME IS FALLING



“surplus” fell during the 1980s as trade deficits emerged, it stayed positive—and actually rose a bit late in the decade as a weakening dollar boosted the dollar value of America's foreign investment returns and helped shrink the trade deficit.

Until recently, this positive income has helped offset the negative impact of the trade deficit on the payments balance—limiting America's growing dependence on foreign capital. Now, however, America's net foreign debt—over \$1 billion at last count—has evidently reached the point at which net income flows (profits, dividends, and interest) start reinforcing the effects of trade deficits and adding to U.S. capital needs. Further, as interest has to be paid on new foreign capital required to finance the deterioration in investment income, the deficit in income flows will inevitably widen. Economists at DRI/Mc-

Graw-Hill predict that the income shortfall will hit a \$20 billion annual rate within a year. Other things being equal, that spells more downward pressure on the dollar and upward pressure on U.S. interest rates.

HOUSEHOLDS GO ON A T-BILL SPREE

Higher rates lure small investors

A lot of key players have withdrawn from the Treasury market since bond prices tumbled earlier this year. With redemptions outpacing inflows, bond mutual funds are out of the action. Banks have become net sellers to obtain the wherewithal for their rising lending activity. Big long-term buyers such as pension funds are looking elsewhere, and currency concerns have turned off foreign private investors.

So who's buying? As in past cycles, says economist Robert V. DiClemente of Salomon Brothers Inc., it's the small investor who has stepped up to the plate. Federal Reserve data indicate that households bought some \$107 billion worth of Treasuries in the three quarters ending in June, rivaling the full-year record of \$114 billion in 1990. And the pace seems to have continued in the third quarter.

Stung by sizable capital losses in mutual funds, a lot of households are evidently eyeing the higher interest rates on short-term Treasuries. Two-year yields, for example, are up by 300 basis points in the past year. With interest rates on bank deposits less competitive, “small investors have found a home in Treasuries,” says DiClemente.

THE STRETCH IN MEXICAN WAGES

Cash benefits make a big difference

The notion that Mexican workers who compete with their U.S. counterparts make a dollar or two an hour is wide of the mark, reports Hewitt Associates, a benefits consulting firm. While the minimum wage in Mexico is about \$4.50 a day, average starting wages (aside from “maquila” operations along its northern border) are far higher, and all Mexican workers receive a raft of other payments and benefits, most of which are mandated by law.

Hewitt notes, for example, that Mex-

ican workers receive full pay 365 days a year, though they take vacations and holidays and usually work only 40 to 48 hours a week. On average, they receive 30 days extra pay as a Christmas bonus and as much as 80% extra pay as a vacation bonus. Other standard benefits include profit-sharing plans, punctuality bonuses (averaging 15 to 20 days' pay for perfect attendance over a year), savings plans, and food coupons.

The upshot is that base pay constitutes only 30% of a Mexican worker's total compensation, vs. over 70% in the U.S. Based on a survey of U.S. and Mexican companies (including multinationals operating in both countries), Hewitt Associates calculates that their effective hourly compensation (wages, benefits, etc.) for production workers last year averaged \$6 in Mexico, compared with \$16.70 in the U.S.

HIDDEN GOODIES IN MEXICAN PAY

EFFECTIVE HOURLY WAGE*

BASE PAY OTHER**

\$1.77 \$4.23

MEXICO \$6.00

\$11.90 \$4.80

U.S. \$16.70

*Non-managerial workers in 1993
**Includes vacation pay, social security, and other payments and benefits

DATA: HEWITT ASSOCIATES

HOW SECURE ARE U.S. JOBS?

More than you think, say the data

In the turbulent 1980s, as restructuring and downsizing gathered steam in the U.S., job security began to seem a vestige of the noncompetitive past. But has job stability really changed that much?

To find out, economists Francis X. Diebold and Daniel Polsky of the University of Pennsylvania and David Neumark of Michigan State University recently analyzed worker survey data for the years 1983, 1987, and 1991. In all three years, they found that a bit over 35% of workers had been employed at the same job for three years or less. But they found only a slight decrease in the percentage of workers holding jobs for at least four years—mainly among blacks, high school dropouts, and high school graduates relative to college grads.

Notwithstanding the wage declines suffered by such groups during the 1980s, the results suggest that the loss of job stability has been exaggerated.

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AMES C. COOPER & KATHLEEN MADIGAN

DON'T LET INFLATION'S GHOST POOK YOU THIS HALLOWEEN

U.S. ECONOMY

It's not too early to think about your Halloween costume. But let Freddy Krueger masks or Grim Reaper outfits if you plan to trick-or-treat down Wall Street. If you really want to scare the markets, just dress up like the inflation monster.

The financial markets approached the September price index with all the edgy anxiety of people visiting a haunted house. Much to their relief, though, there were no primary ghouls to be found. Producer prices of finished goods actually fell 0.5%, and rose just 0.1% excluding food and energy.

Also, too, the consumer price index looked pretty tame. The CPI was up 0.2% in September, and excluding food and energy prices, the core index increased 0.2%. The yearly inflation rate now stands at 3% for both the total index and core. Inflation has picked up some since the spring, but lack of any visible pressure from tight labor markets and capacity constraints suggests the rate will move up gradually through 1995.

A DIVERGENCE IN PRICE TRENDS



JAN '92 SEPT '94
PERCENT CHANGE FROM A YEAR AGO
SOURCE: LABOR DEPT., BUSINESS WEEK

Service inflation continues to edge lower, even as increases in goods prices have picked up (chart). Bigger price tags for tobacco, used cars, and food have lifted goods inflation. For October, energy prices probably increased because of the higher pump price for oxygenated gasoline required for environmental reasons during the winter. In general, however, any acceleration in goods inflation will be reined in by foreign competition, falling unit labor costs in manufacturing, and the recent slowdown in commodity prices.

In August, prices for consumer-goods imports were up only 2% from a year earlier. And the Knight-Ridder Commodity Research Bureau's index of commodity futures is below its June peak and has been gradually declining since early September.

COMMODITY PRICES as well as overall inflation are getting some steam because the economy is showing the effects of past interest-rate hikes by the Federal Reserve. The latest data on retail sales, industrial production, and capacity are hardly the stuff that should keep bond traders up at night.

Of course, what's a pleasant read on Wall Street can be

a Stephen King hair-raiser on Main Street. A more moderate pace of economic growth means consumers will see slower hiring and income growth. Add in the Fed-engineered bite from higher adjustable-rate mortgage payments, and it is easy to see why consumer spending is downshifting from its surge of late 1993 and early 1994.

Of course, consumers aren't forgoing shopping altogether, as they would in a recession. Retail sales rose 0.6% in September, and the Commerce Dept. revised upward the July and August data. The September strength was mostly in durable goods: Demand for autos, building materials, and home furnishings remains strong. Receipts at apparel stores, which should have benefited from a solid back-to-school season, fell 1.5%.

The September gain means that retail volume likely grew at an annual rate of about 3.9% in the third quarter. With outlays for services rising at a subdued pace, total real consumer spending probably grew at about 3% last quarter. While that is double the 1.3% creep of the second quarter, the pace hardly compares with the showing in the previous three quarters.

The return of shoppers last quarter prompted retailers to continue stocking their shelves. Retail inventories surged 2.4% in August, leading the 1% advance in total business stockpiles. The ratio of retail inventories to sales jumped to its highest level since the blizzard-related bulge in early 1993. Excluding cars, the ratio is the highest in 6½ years.

THE AUGUST BUILDUP indicates that inventory accumulation did not slow as much in the third quarter from its jump in the second quarter as many analysts had expected. The slowdown in domestic demand, though, especially in the construction sector, means real gross domestic product probably grew in the neighborhood of 2% last quarter, at an annual rate. If so, that pace is below the point at which the economy can expand without touching off inflation pressures.

The GDP data, to be released on Oct. 28, won't get any lift from foreign trade. In August, the trade deficit in goods and services narrowed to \$9.74 billion from \$11.19 billion in July (chart). So far in the third quarter, the trade gap is running slightly wider than the second-quarter average, suggesting that the bigger trade deficit is subtracting from GDP

IMPORTS OVERWHELM RECORD EXPORTS



GOODS & SERVICES
JAN '92 AUG '94
BILLIONS OF DOLLARS
DATA: COMMERCE DEPT.

growth. True, exports are gaining strength as world growth picks up, but imports still flood U.S. shores. In August, exports jumped 6.1%, to a record \$59.8 billion, led by aircraft, cars, and industrial materials. But imports, up 3% to \$69.5 billion, also hit a new high. Goods from China soared 14%, causing a sharp widening of the U.S.-Chinese deficit.

The third quarter may mark the bottom for trade deterioration in this business cycle. Imports should follow the slowdown in U.S. demand, and exports should benefit from recoveries abroad and the weaker dollar.

FOR MANUFACTURERS, the livelier beat of exports helps offset slower demand in the much bigger domestic market. Industrial production was unchanged in September, with factory output rising 0.1%. Operating rates for all industry averaged 84.6%, just below 84.8% in August.

September activity would have been peppier, but a strike and shortages of some parts caused a 1.6% drop in auto-industry output. Even excluding motor vehicles, though, factory production was up just 0.2%.

Vehicle output is expected to come back in the fourth quarter, although the gain won't match the phenomenal growth in the fourth quarter of 1993. Sales of cars and trucks have slowed since July.

The busiest manufacturers continue to be business-equipment makers, reflecting the boom in capital spending for new equipment. Their output is up 12.3% from a

year ago (chart). Production of computers and other equipment has soared by 26.2% over the past four quarters. Output of business gear has helped overall factory production. It rose at an annual rate of 7% last quarter down from 7.3% in the second and 7.8% in the first.

Inflation hawks, however, could hardly quarrel with the growing demand for business equipment, especially computers. For most businesses, they provide the means to boost productivity and keep a lid on labor costs.

The smaller increases to wage bills are leading to a surprisingly strong performance in corporate profits in the third quarter (page 42). Part of those strong earnings will likely be plowed back into more business equipment, helping to keep the uptrend in productivity going.

Better efficiency is one of the most powerful arguments for a continued moderation in inflation. Add in slower demand, the resistance of consumer paying higher prices, and intense competition, and it's hard to see why price pressures will build in the near future. So go ahead and revel in the frights and screams of this year's Halloween knowing that inflation is one ghost you don't have to fear.



NORTH AMERICA

CANADA IS IN CLOVER—BUT ROLLING IN DEBT

If not for Canada's dangerous fiscal predicament, its economy would have the brightest outlook in the industrialized world. Canada will end 1994 with the fastest growth and the lowest inflation of any major country, and a similar pattern is expected for 1995.

Vigorous exports and rising commodity prices in this resource-rich nation are boosting industrial output and corporate earnings, which in turn are fueling a capital-spending boom.

Economists expect real gross domestic product to grow about 4% this year and to come close to that in 1995. Inflation, currently near zero, is exaggerated on

the low side by a cut in cigarette taxes, but it should reach only about 2% next year.

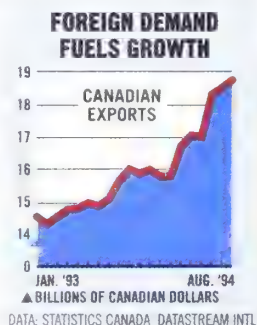
However, total government debt has ballooned to 100% of GDP. And interest on that debt—some 25% of

Ottawa's budget—is growing faster than the economy. "We're in hock up to our eyeballs," warned Finance Minister Paul Martin at his economic and fiscal update before Parliament on Oct. 17-18.

Even with the help of a strong economy, Martin predicts that Canada will still ring up a fiscal 1994-95 deficit of C\$39.7 billion (U.S. \$29.4 billion), only slightly below last year's record. On Oct. 18 Martin

said he would have to slash spending by an additional C\$7.3 billion to reach Ottawa's 1996-97 target of C\$25 billion, or 3% of GDP. For now Canada's financial markets have welcomed Martin's resolve, but those markets are still looking for hard evidence of his commitment.

Since Aug. 2, the Toronto stock market has gained 2.9%, while the Canadian dollar is up 2.5% vs. the U.S. dollar. Still, Canada's currency is near an eight-year low, thanks to its fiscal woes. Also, the country's enormous reliance on foreign investors has lifted real interest rates to levels that are among the highest in the industrialized world. Until Ottawa moves decisively to clean up its fiscal mess, the financial markets—and the Canadian economy—will remain at risk.



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A BRUTAL MORNING AFTER

How bad is Wall Street's headache?

Where did the good times go? A year ago, investment banks were swimming in bucks, reveling in stock and bond markets that seemed only to go up. Look at the mess now. Salomon Inc. expects to lose \$100 million in its third quarter, atop a \$204 million loss in the second. Profits are down sharply at Bear, Stearns & Co. and Morgan Stanley & Co. Brokerage stocks are in the tank, off some 13% so far this year. And industry layoffs total 2,000 so far in 1994, and 8,000 more jobs may go in the next 12 months. "The bleeding is far from over,"

says John Utendahl, who heads his own money-management firm. "There is no guarantee what next year will bring."

On Oct. 17, General Electric Co. bailed out, agreeing to sell its long-troubled Kidder, Peabody & Co. unit, which lost \$85 million in the third quarter. Only GE's deep pockets saved the old-line firm from going under in the face of mortgage-backed securities losses and the Joseph Jett trading scandal. Now, Paine-Webber Inc. will buy Kidder for \$670 million in stock; in the next few months, it may reduce the firm's workforce by as much as half, to some 2,500.

Scary days. They're the result, mainly, of the biggest bond-market debacle in recent memory. While interest rates declined from 1991 to 1993, Wall Street big houses virtually minted money, their huge bond inventories generating far more in yield than they cost to finance. Corporations, meanwhile, rushed to issue low-cost debt, generating 1% underwriting fees. The party ended abruptly last Feb. 4, when the Federal Reserve hiked interest rates for the first time in five years. Government bond yields surged two percentage points, to 7.81% by Oct. 19. "What the Fed giveth, t



TRADERS ON A BREAK: FED RATE CUTS HAVE TAKEN A HEAVY TOLL

also taketh away," says Michael Agan, analyst with Lipper Analytical Securities Corp. "This downturn is nowhere near as full as previous slumps—thanks largely to recent cost-cutting and conservative expansion when business was—and deal activity is booming. Still, underwriting and trading activity has been muted, producing losses of \$623 million for the Street in 1994's second quarter, compared to \$2.35 billion in the same quarter last year. New bond and equity issues declined 51%, to \$1.5 billion, in the third quarter from

NO PARTY The Street still suffers from overcapacity—too many traders, brokers, and bankers chasing too little business. But look beyond bonds, and there are some bright spots

the same period last year, says Securities Data Corp. While the stock market is up slightly this year, initial public offerings were down 47% in the quarter, to \$4.8 billion.

The worst hit: those most dependent on their fixed-income businesses, such as Salomon and Lehman Brothers Inc. Lehman posted just \$22 million in second-quarter earnings, down 79% from a year earlier. Salomon dropped millions in the bond markets and took a hit in the third quarter for losses in proprietary trading. The carefully constructed hedges at top firms such as Goldman, Sachs & Co. failed to protect portfolios from such an abrupt, rapid rise in rates.

GLOBAL GIANTS. The mortgage-backed securities markets got whacked especially hard. As interest rates rose, the number of homeowners who refinanced their mortgages dropped dramatically, lengthening the time many mortgage-backed holders had to wait to be paid off. That sent prices tumbling and quickly dried up what had been a liquid mar-

ket. Much like investors in the junk-bond market in 1990, customers raced to the sidelines, leaving the firms that specialized in mortgage-backed instruments with little trading and underwriting business. Kidder was hurt badly, as were Salomon and Bear Stearns. Bear Stearns's earnings dropped 66% in its quarter ending Sept. 30.

There's more contraction to come. The securities industry still suffers from pronounced overcapacity—too many traders, brokers, and bankers chasing too few deals. Wall Street is headed toward a handful of goliaths, such as Merrill Lynch, Goldman, and Morgan Stanley, that can play in a global arena.

But this time around, securities firms are structured better to handle the downturn. Wall Street is leaner than it has been in years, thanks to its shakeout from the 1990 industry downturn. Overhead expenses are lower, and asset quality is stronger, says Moody's Investors Service Inc. "Most securities firms year-to-date are still profitable, and their re-

Blood on the Street

The tumultuous bond market, weak underwriting, and shrinking fees have wreaked havoc on investment banks, cutting deeply into 1994 profits

Firm	Assessment	Net income	
		1993	1994 Est.
MERRILL LYNCH	Profits were down 27% in the second quarter and 36% in the third, on weak trading and underwriting. Merrill has laid off 4% of its bond unit.	\$1,359 million	\$975 million
SALOMON BROTHERS	Trading losses were expected to force a \$100 million third-quarter loss, atop a \$204 million loss in the second quarter. No layoffs yet.	864	232
MORGAN STANLEY*	Profits were down 45% in the second quarter. M&A business remains strong, though, balancing underwriting weakness. Morgan is still hiring.	786	510
LEHMAN BROTHERS**	Since the start of the year, staff has shrunk by 8.5%. Profits were down 79% in second quarter, as rising rates hurt debt trading and underwriting.	326	91
BEAR STEARNS***	Losses in mortgage-backed securities contributed to a 66% profit drop in quarter ended Sept. 30. But head count is up 17% in the past year.	387	286

*Year ends Jan. 31

**Year ends Nov. 30

***Year ends June 30

DATA: BLOOMBERG FINANCIAL MARKETS, ZACKS INVESTMENT RESEARCH

turn on equity is well north of 10%," says Moody's Ryan O'Connell. "Corporate America would be happy with returns like that."

Indeed, look past the bond market, and there are some bright spots. Discounting has driven mergers-and-acquisitions fees down to an average of 1.2% of transaction value, from 2.2% in 1993, according to Securities Data. But deal volume is booming, driven by strategic consolidation in the health, defense, and telecommunications businesses. In the third quarter, companies announced \$108

billion worth of deals—the most ever. Salomon, a relative newcomer to M&A, did the most deals in the U.S. in the quarter, joining Morgan, Goldman, Merrill, and Lazard Frères as the biggest dealmakers. Privatizations are another hot area for Wall Street firms, as state-owned companies use U.S. investment banks to market their equity globally. **SWEET DEAL.** Some firms have positioned themselves well for new, leaner times. Merrill Lynch is reaping the rewards of years of diversification into areas such as asset management. It post-

ed healthy profits of \$232 million in the third quarter, though down 36% from record third quarter last year.

Indeed, not all of Wall Street's players are laying people off. Morgan Stanley sees big growth overseas, where it earned 47% of its 1993 revenues. The firm plans to hire 30 people to start a bond-trading operation in Canada. "Morgan Stanley is not considering cutbacks and is adding in key areas," says spokeswoman. PaineWebber, with the addition of about half of Kidder's 500 employees, is expanding as well.



CORPORATE PROFITS

THIS TRAIN KEEPS GAINING STEAM

Economists expected a slow third quarter. Boy, were they wrong

Nobody figured third-quarter corporate profits would be much to crow about. Well, take a look at the early results. Instead of the slowdown economists expected, the profits of 83 companies in BUSINESS WEEK's flash report on third-quarter profits rose 36% on a solid 13% jump in revenues. Once all companies have reported, earnings are expected to be up at least 19%, says I/B/E/S Inc., which tracks earnings estimates. Leading the way: the banks and turnarounds such as Conner Peripherals Inc. The good news may continue, too. "I expect a blowout fourth quarter and a strong but slowing first half of 1995," says Nomura Research Institute chief strategist Carmine J. Grigoli.

	CURRENT QTR. SALES (MILLIONS)
INDUSTRIALS	106,725
ABBOTT LABORATORIES	2,254
ALCOA	2,561
ARCHER DANIELS MIDLAND†	1,090
BOISE CASCADE	1,090
BRISTOL-MYERS SQUIBB	2,931
CHAMPION INTERNATIONAL	1,384
CHRYSLER	11,659
CONAGRA†	6,245
COOPER TIRE & RUBBER	383
CORNING	1,452
GENERAL ELECTRIC	16,153
GEORGIA-PACIFIC	3,283
GOODRICH (B.F.)	561
HASBRO	796
INLAND STEEL INDUSTRIES	1,129
INTERNATIONAL PAPER	3,800
JOHNSON & JOHNSON	4,038
LILLY (ELI)	1,817
MATTEL	1,037
MCDONNELL DOUGLAS	3,461
MERCK	3,792
PACCAR	1,167
PEPSICO	7,064
PHILIP MORRIS	16,710
REYNOLDS METALS	1,531
RUBBERMAID	580
SCOTT PAPER	1,172
SHERWIN-WILLIAMS	876
TRW	2,164
UPJOHN	859
WEYERHAEUSER	2,680
WHIRLPOOL	2,085
SERVICES	34,577
AMR	4,233
BARNETT BANKS	N
BEAR STEARNS†	809
CBS	726
CHASE MANHATTAN	N
CHEMICAL BANKING	N
CITICORP	N
CPC INTERNATIONAL	1,812
DOW JONES	501
FEDERAL EXPRESS†	2,231
FIRST CHICAGO	N

running the firm under the expectation that conditions will remain the same two quarters, maybe three," says PaineWebber Chief Executive Donald Barron. "Then we are very optimistic forward."

Barron certainly got a sweet deal on the deal, which GE seemed desperate to do. In essence, PaineWebber can acquire just the Kidder businesses it wants for \$90 million—the difference between the \$670 million PaineWebber will issue in common and preferred stock and the \$580 million it will get back in liquid marketable Kidder assets. PaineWebber, whose earnings were expected to decline 66% in the third quarter, be-

Firms can weather a year or so of lower trading volume, but after that...

lieves it can make \$100 million in annual pretax profits with the added Kidder assets. And GE will foot the bill for severance payments to any PaineWebber employees laid off in the merger—in addition to those for Kidder workers.

No matter how favorable the deal's terms, though, the real question for PaineWebber—and for the rest of Wall Street—is this: Where are interest rates going? "If one predicts a lot higher rates, it would make the outlook bearish," says Stephen Robert, chairman of Oppenheimer & Co. Indeed, another year of rising rates would strain PaineWebber's ability to make the Kidder acquisition work. Other firms can weather a year or so of lower underwriting and trading volume, but after that, their expansion plans go out the window. Layoffs would accelerate. The bottom line: It's nail-biting time on Wall Street.

By Leah Nathans Spiro in New York

% CHG.	EST. EPS (8/18)	REPORTED EPS	DIFF.
-32	0.78	0.83	-0.05
+11	0.43	0.43	—
+143	0.43	0.79	+0.36
+124	0.37	0.45	+0.08
NM	-0.46	-0.48*	-0.02
+2	1.22	1.22	—
NM	-0.17	0.18	+0.35
+54	1.36	1.76	+0.40
+14	0.32	0.31	-0.01
+41	0.38	0.42	+0.04
NM	0.57	0.36	-0.21
+13	0.81	0.80	-0.01
NM	0.83	0.98	+0.15
+50	0.82	0.82	—
-1	0.82	0.85	+0.03
+80	0.56	0.54	-0.02
+127	0.87	0.87	—
+16	0.78	0.82	+0.04
+8	1.00	1.10	+0.10
+26	0.77	0.72	-0.05
+13	3.48	4.07	+0.59
+11	0.63	0.62	-0.01
+46	1.35	1.37	+0.02
+18	0.64	0.68	+0.04
+27	1.39	1.42	+0.03
NM	0.06	0.26*	+0.20
+11	0.42	0.41	-0.01
+146	0.69	0.80	+0.11
+11	0.81	0.83	+0.02
+63	1.09	1.26	+0.17
NM	0.62	0.76	+0.14
+117	0.76	0.71	-0.05
+40	1.12	1.30	+0.18
+15	0.85	0.98	+0.13
+64	2.18	2.47	+0.29
+11	1.17	1.21	+0.04
-66	0.55	0.25	-0.30
-51	0.95	0.77	-0.18
+14	1.29	1.49	+0.20
-13	1.33	1.60	+0.27
+69	1.30	1.87	+0.57
+3	0.85	0.83	-0.02
+14	0.34	0.34	—
+86	0.90	1.08	+0.18
-46	1.51	1.54	+0.03

	CURRENT QTR. SALES (MILLIONS)	% CHG.	QTR. PROFITS (MILLIONS)	% CHG.	EST. EPS (8/18)	REPORTED EPS	DIFF.
FOOD LION							
	1,849.8	+2	36.6	+48	0.08	0.08	—
HILTON HOTELS							
	380.9	+10	27.0	+32	0.62	0.56	-0.06
HUNT (J.B.) TRANSPORT							
	313.9	+24	12.3	+40	0.35	0.32	-0.03
MARRIOTT INTERNATIONAL							
	1,813.0	+18	37.0	+28	0.26	0.28	+0.02
MBNA							
	NA	NA	73.8	+30	0.47	0.49	+0.02
McGRAW-HILL							
	855.5	+54	90.2	NM	1.78	1.82	+0.04
MERRILL LYNCH							
	4,530.2	+9	231.6	-36	1.21	1.10	-0.11
MORGAN (J.P.)							
	NA	NA	327.0	-30	1.72	1.63	-0.09
NATIONSBANK							
	NA	NA	431.0	-26	1.55	1.55	—
OFFICE DEPOT							
	1,044.8	+44	27.4	+42	0.16	0.18	+0.02
SAFeway							
	3,631.8	+2	63.7	+51	0.45	0.52	+0.07
SANTA FE PACIFIC							
	680.0	+16	50.5	NM	0.28	0.27	-0.01
TIME WARNER							
	4,099.0	+10	-32.0	NM	-0.09	-0.09	—
TRAVELERS							
	4,714.2	+134	331.3	+28	0.98	0.97	-0.01
UNITRIN							
	350.0	+3	49.9	+249	NA	1.00	NA
WELLS FARGO							
	NA	NA	217.0	+32	3.76	3.86	+0.10
TECHNOLOGY							
	27,553.5	-21	2,088.9	-78	0.69	0.71	-0.02
ADVANCED MICRO DEVICES							
	543.1	+30	86.7	+41	0.82	0.86	+0.04
APPLE COMPUTER††							
	2,493.3	+16	114.7	NM	0.64	0.95	+0.31
COMPAQ COMPUTER							
	2,838.0	+63	201.0	+88	0.74	0.75	+0.01
CONNER PERIPHERALS							
	559.5	+6	10.2	NM	0.40	0.20	-0.20
DIGITAL EQUIPMENT							
	3,122.5	+4	-130.6	NM	-1.14	-0.98	+0.16
GENENTECH							
	193.8	+17	33.6	+116	0.26	0.28	+0.02
HONEYWELL							
	1,507.6	+4	69.4	-14	0.53	0.54	+0.01
INTEL							
	2,863.0	+28	659.0	+13	1.53	1.52	-0.01
LOTUS DEVELOPMENT							
	235.2	-2	-66.4	NM	0.38	-1.39	-1.77
MICROSOFT†							
	1,247.0	+27	316.0	+32	0.48	0.51	+0.03
MOTOROLA							
	5,660.0	+28	380.0	+50	0.59	0.65	+0.06
RAYTHEON							
	2,443.0	+10	191.9	+12	1.47	1.45	-0.02
SUN MICROSYSTEMS†							
	1,273.4	+33	38.4	+131	0.25	0.40	+0.15
TEXAS INSTRUMENTS							
	2,574.0	+19	185.0	+26	1.88	1.94	+0.06
UTILITIES & TELECOM							
	27,902.6	-5	3,042.3	-66	0.65	0.67	-0.02
AMERICAN ELECTRIC POWER							
	1,385.0	-1	139.8	NM	0.71	0.76	+0.05
BELL ATLANTIC							
	3,415.3	+4	397.4	+3	0.90	0.91	+0.01
ENRON							
	1,997.4	+3	96.0	+357	0.32	0.38	+0.06
GTE							
	4,995.0	+1	659.0	+18	0.62	0.69	+0.07
MCI COMMUNICATIONS							
	3,407.0	+12	220.0	+26	0.36	0.38	+0.02
PACIFIC TELESIS							
	2,329.0	-1	314.0	+2	0.68	0.74	+0.06
PUBLIC SERVICE ENT. GROUP							
	1,375.0	-2	187.2	-3	0.77	0.76	-0.01
SBC COMMUNICATIONS							
	3,000.1	+7	480.8	-9	0.78	0.80	+0.02
SPRINT							
	3,233.8	+13	230.1	+68	0.63	0.66	+0.03
U S WEST							
	2,765.0	+7	318.0	NM	0.72	0.70	-0.02

† First-quarter results

†† Fourth-quarter results

NM = not meaningful

NA = not available

*EPS adjusted for special items

DATA: STANDARD & POOR'S COMPUSTAT, A DIVISION OF McGRAW-HILL INC. EARNINGS ESTIMATE DATA PROVIDED BY I/B/E/S INC., NEW YORK, NY. I/B/E/S IS REGISTERED TRADEMARK OF I/B/E/S INC.

LETTER FROM THE CAMPAIGN

RALLYING THE FAITHFUL —AT LEAST A FEW OF THEM

Why is a President shunned by his party still out on the stump?

It's early on Saturday morning, Oct. 15. But Bill Clinton can't put in a lazy day on the golf course. Instead, he'll spend a grueling 16 hours on and off Air Force One. First stop: Bridgeport, Conn. Mission: to rally the party faithful.

Carrying an entourage that includes Hillary Rodham Clinton, the plane lands at Sikorsky Memorial Airport. The group transfers to Marine One, which makes a dramatic landing to the blare of high school bands just yards from 2,000 flag-waving partisans. Lynn Kollar, 44, a flight attendant for Business Express Inc., voted for Ross Perot in 1992 but now backs Clinton. "He inherited a lot of problems," she says. "He's doing the best he can."

BIG BUCKS. If only more voters felt like that. Clinton knows he's not exactly Mr. Popularity. Indeed, some campaigning Democrats are loath even to be seen with the President. So why the dogged campaigning? In some places, he can energize Democrats to bring out the vote. But a more compelling reason: money. Even in the face of sinking approval ratings, Clinton can still draw the big bucks his party needs.

The President was invited to Connecticut by Comptroller William E. Curry Jr., who is locked in a tight race for governor. As Curry beams, Clinton delivers a spirited defense of his White House record. Republicans, he warns, "are going to give us their trickle-down economics of the 1980s." Then he asks: "Are we going forward, or are we going back?"

After the rally, the motorcade passes through the kind of working-class neighborhood that Clinton is targeting. Onlookers wave. Then the President gets



BOYS IN BLUE: Defending his record to an audience of police

down to the other business of his trip. Attending two packed fund-raisers at the downtown Holiday Inn, Clinton pulls in \$300,000 for the cash-short Curry.

On to Miami, where Clinton is to star at a fund-raiser for Senate candidates. On the way, though, he stumbles into an

ELECTION '94

advance man's nightmare: His wife has talked him into a last-minute event for her brother, Hugh Rodham, a political neophyte running for the Senate. Rodham's supporters predicted a big turnout at a Port of Miami terminal. Instead, the Clintons find a group of 200, including seniors bused from condos. Still, Bill and Hillary work the crowd with gusto. Monique Lis, an actress in a leopard-spot miniskirt, is there because she's a friend of a campaign worker. "It's interesting to see a President up close," she says. "He's not my favorite President, though." George Bush is.

All that's a sideshow—despite embarrassing publicity about the low turnout. After the Rodham rally, Clinton puts in an appearance at a tony dinner with

Florida's Establishment. The event costs \$1 million. Finally, he boards Force One, arriving home at 1:30.

A day later, he's off again—this time to Albuquerque to deliver an anticrime speech before the International Association of Chiefs of Police. White House officials insist this is a "nonpolitical" event. The cops find that amusing. "It's all political," laughs North Olmsted

(Ohio) Police Chief Dennis S. Seftick.

POLITE APPLAUSE. With voters listing crime as the No. 1 concern, Clinton expects to pass up appearing on a stage with two dozen boys in blue—a photo op well worth the 12-hour round-trip journey at taxpayer expense. He wins only polite applause when he reminds skeptical officers that he fought an anticrime bill. "When they stop the funding, they may have to lay off police," sniffs Teaneck (N.J.) Chief Bryan E. Burke. They thought, with Clinton's emotional sermon on the need for parents to impart values to children. His speech ends with a hit. "He really cares," says

Seftick, a Bush voter, says. "He's more law-and-order than I thought."

But Clinton's Albuquerque visit is a touchy one for Governor Bruce K. Springsteen and Senator Jeff Bingaman, both facing tough reelection bids. They aren't sure that a public appearance with Clinton will be a plus. The candidates stand in a receiving line for a handshake as the President arrives, then Clinton hops into his limo without a word of public support for either candidate. "They don't need that kind of help," says a White House official. "They need help with money." Later, the President delivers, showing up at a closed meeting with King's financial backers.

Upcoming stops: California, Seattle, Ohio. Then, at the end of the month, Clinton heads to Israel and Jordan. There are no voters in the Middle East, but the President hopes the trip will lift his popularity ratings back home—and, with them, the prospects of his fellow Democrats.

By Susan B. Garland in Bridgeport, Conn., and Albuquerque, with Peter Valdes-Dapena in Miami

Sure, Clinton's ratings are low—but even an unpopular President can serve as a money magnet



E RACE FOR CONGRESS

THE TARNISHED KNIGHTS OF BUSINESS

Backlash is hurting executives seeking office

Republican strategists thought they had found the perfect combination to unseat some venerable Democratic incumbents: a brigade of handsome, successful executives armed with plenty of disposable income and unburdened by a voting record. Political outsiders, they could run as commonsense reformers who would make government mirror their successful businesses. But many of the races aren't following the GOP script. Instead, nouveau pols have found themselves on the defensive over their supposed forte: their capitalist résumés. "Business backgrounds can be a liability as much as an asset," says Democratic consultant Mark McKinnon. "If you don't have political records, their business record is their record."

In case in point: California, where Republican Representative Michael Huffington, the son of a Texas oil baron, has lost about \$17 million of his own fortune to unseat Democratic Senator Diane Feinstein. In recent weeks, Feinstein has unveiled blistering ads that attack Huffington's carefully crafted image as a visionary business leader. **GED FIGURES?** Feinstein, whose own net worth approaches \$50 million, alleges that one bankrupt Huffington family business owes \$6.7 million in back taxes, while another defaulted on \$6 million in loans to a failing bank "and left investors to pick up the bill." The Huffington campaign says Feinstein has misrepresented the fallout of a typical busi-

ness failure to demonize their candidate. Huffington's unfavorable rating, though, has nearly doubled in a month.

In Massachusetts, meanwhile, Republican venture capitalist Mitt Romney scored early points by boasting that he helped create 10,000 jobs over a decade. But Senator Edward M. Kennedy counterattacked by painting Romney as a heartless profiteer who denied health benefits to some workers and fired pregnant and elderly employees—while raking in \$11 million for himself.

One series of Kennedy ads featured Indiana workers who claim Romney's firm took over their factory and slashed jobs and benefits. Never mind that Romney had left his firm months before the factory was bought. The ad campaign "has overwhelmingly distorted my business career," says Romney. "[Kennedy]

JOB KILLER? Romney is painted as a heartless profiteer by Kennedy's camp

would like people to believe that if you're in the business world and you're trying to make money for your investors, you're unqualified for public office." Even so, Kennedy has regained a narrow lead.

Where they can't accuse opponents of business sleaze, Democrats dismiss Republicans as flops. Texas Republican George W. Bush trumpets his business experience—from energy investments to the Texas Rangers—in his bid to be governor. But incumbent Democrat Ann W. Richards calls him a failure whose ventures have lost \$372 million. Bush shrugs off the barbs as "Texas politics at its mudslinging worst."

LAWYER ON TRIAL. Republican National Committee Chairman Haley Barbour labels the assaults "a transparent attempt to change the subject." But some Democratic execs are facing similar scrutiny. Underdog Ohio Democratic Senate nominee Joel Hyatt has been hurt by reports of layoffs and lawsuits at his cut-rate legal-services company.

On the other hand, a Democratic business-pol with an unblemished record can woo swing voters. In Arizona, supermarket tycoon Eddie Basha—known as "your friendly, chubby grocer"—is leading Republican Governor Fife Symington, a former real estate developer. "Eddie Basha's conservative business orientation makes him much more acceptable to Republicans," says Arizona State University pollster Bruce Merrill.

Still, the attacks on executives "may deter businesspeople from seeking office," says John J. Pitney Jr., a political scientist at Claremont McKenna College. Even if some of the roughed-up business candidates eke out victories this November, their vulnerability has been made clear. The next campaign season, pinstriped political wannabes will think harder before jumping in with eyes closed and wallets open.

By Richard S. Dunham, with Howard Gleckman, in Washington and Mark Maremont in Boston

ELECTION '94

TROUBLED RESUMES

MASSACHUSETTS

Republican Senate candidate
Mitt Romney

	SEPT.	OCT.
Favorable	44%	40%
Unfavorable	23	31

Ratings drop after Senator Kennedy attacks job cuts made by company owned by Romney's venture firm.

DATA: KRC COMMUNICATIONS RESEARCH FOR THE BOSTON GLOBE; LOS ANGELES TIMES POLL

CALIFORNIA

Republican Senate candidate
Michael Huffington

	SEPT.	OCT.
Favorable	23%	31%
Unfavorable	23	45

Huffington loses ground when incumbent Diane Feinstein attacks his family's oil and gas fortune.

STRATEGIES

A SUITOR BLINDED BY LOVE?

As Consecos closes in on Kemper, investors stay skeptical

Stephen C. Hilbert is walking around Kemper Corp. as if he already owns the place. In his frequent visits to the financial-services company, the Consecos Inc. chairman has chatted up Kemper brokerage employees over their squawk boxes and hashed out strategy in closed-door sessions with top brass. He even has unveiled plans to move Kemper's insurance companies from suburban Chicago to suburban Indianapolis, where Consecos is based. "He's very confident," says a Kemper employee who sat through a Hilbert presentation.

Investors have a message for Hilbert: Not so fast. Since June 23, when it announced its \$3.25 billion cash and stock deal to buy Kemper, Consecos's stock has plunged more than 27%, to 37¢ per share on Oct. 19. That day, meanwhile, Kemper's stock dipped to 55¢ over worries that the deal may not go through. That's more than \$11 below the offer's original \$67-per-share estimated value.

STORMY MARKETS. Will this deal fly? Most analysts remain convinced it will. But they doubt it will close by yearend as planned. And they're fretting over whether Consecos's third-quarter earnings will fall short of expectations when the company reports them on Oct. 27. Another worry: whether Hilbert will abandon plans to sell assets in order to raise cash and instead rely more heavily on debt. Consecos's chief is "acting like a man who's going to close this deal, but the details are making everyone nervous," says T. Rowe Price Associates Inc. analyst Robert N. Gensler. He predicts Hilbert will pull off his deal, but his firm has trimmed its Kemper holdings by some 62% since March.

Even if Hilbert prevails, he could be badly overpaying for Kemper. His bid of \$56 in cash and \$11 in Consecos stock topped an all-cash offer of \$60 per share from financial powerhouse GE Capital Services Inc. To reduce debt financing,

Hilbert is trying to sell Consecos's stakes in CCP Insurance and Bankers Life & Casualty Co.—with no success so far. Without asset sales, the merged Consecos-Kemper would have about \$3 billion in long-term debt, more than twice its



HILBERT: The deal is "truly a once-in-a-lifetime opportunity"

equity. "This will be a very highly leveraged entity," says Patrick Finnegan of Moody's Investors Service Inc. Moody's and other rating agencies have put Consecos and Kemper debt on watch for downgrades.

Meanwhile, Kemper's performance is stalling on some fronts. Stormy financial markets have hampered its mutual funds, with assets under management dipping nearly 10%, to \$63 billion, as of the end of August. Its securities brokerage has been hit, too, reporting earnings of just \$116,000 in the first half. And its real estate division holds \$1.1 billion worth of troubled investments, with 21% in undeveloped land that would need more in-

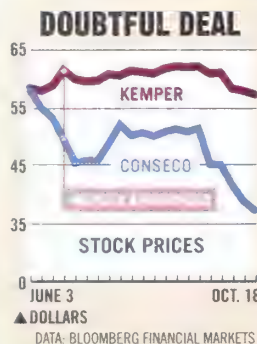
vestment to pay off. Given all that, some Kemper shareholders have bailed out. "There are just too many uncertainties in the picture," says Martin D. Sass, M. D. Sass Investors Services Inc., New York money manager. Sass has dumped its big Kemper stake in recent months.

To be sure, Hilbert, who declined to be interviewed for this story, will get plenty of value out of Kemper, including a well-known brand name and a big increase in fee income. Roughly 40% of the merged company's earnings would come from recurring management fees up from 15% at Consecos today. In addition, Kemper's insurance businesses would fit nicely with Consecos's, and its brokerage operation, with 1,300 brokers and a huge marketing arm, would provide a strong distribution channel for new products and services. "It's truly a once-in-a-lifetime opportunity," Hilbert said when announcing the deal in June.

CONSOLIDATION. Hilbert also has ambitious plans for Kemper. He wants to expand its mutual funds with new products, hire additional brokers, and build an investment banking business. In Securities Exchange Commission filings, Consecos mentions an "orderly liquidation" of Kemper's real estate over the next few years. In addition, the company expects to save as much as \$105 million annually by consolidating data processing and other operations. Eliminating Kemper's home office and cutting insurance payrolls would save millions more.

Hilbert, a former encyclopedia salesman, has walked similar terrain before. He built Consecos over the past decade by buying a dozen small insurance companies, then paring costs to the bone. Consecos has been buying undisclosed amounts of Kemper stock in the open market, a sign of confidence the deal will go through, says Consecos spokesman James V. Rosensteel. As for Wall Street, it can't seem to decide whether it's more afraid that Hilbert won't make the deal fly—or that he will.

*By Greg Burdett
in Chicago*



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LABOR

WHY THE TALKS AT DEERE HIT BEDROCK

Seeing the UAW wither at Cat, management digs in its heels

When Deere & Co. opened contract negotiations with the United Auto Workers in August, it seemed likely that the recent atmosphere of cooperation on the factory floor would smooth the way toward a quick deal—or so both sides predicted. Early talks were friendly, but the company and the union soon found themselves back in a traditional tug-of-war, unable to agree on basic issues. Any pretext of an easy conclusion vanished on Oct. 16, when 90% of Deere's 11,000 UAW-represented employees voted to refuse the company's contract offer.

Why the breakdown? Deere says the two sides are simply too far apart on critical issues, including the company's desire to cut new hires' pay by 30% (table). But the union and other labor observers believe the company hasn't been eager to compromise because rival Caterpillar Inc. has shown that the UAW is vulnerable. Executives at Deere have watched Caterpillar impose a contract on its workforce and weather a strike since late June with little effect on production. Says Chicago management attorney John N. Raudaugh: "Undoubtedly, Caterpillar

is having a lot of impact on Deere."

Deere denies a Caterpillar connection. "We are only looking at the situation that exists between John Deere and the UAW," says a spokesman. And a strike may be averted. Deere says it isn't thinking of imposing a final offer on its workforce yet. UAW members continue to work under the terms of the contract that expired on Sept. 30. The two sides may be back at the bargaining table soon.

But it's hard to figure how the UAW and Deere will settle their differences. Accepting a two-tier wage system is anathema to the union. Yet the company staunchly maintains that it must find a way to pay new workers less to avoid

INTRACTABLE: Talks may resume soon—but nobody's ruling out a strike

being at a disadvantage with rivals, including Caterpillar, where wage scales are lower. The demand is critical for Deere in the long term: The average UAW employee at Deere is less than eight years from retirement. If the company can start new workers at pay levels below the \$22-an-hour average, currently shells out, it will save down the road.

WITHOUT A HITCH. Then there's Deere's pay-for-productivity plan. Company officials say that the scheme, which would link part of wages to efficiency gains, wouldn't cut pay. But the union thinks otherwise, and the plan is so complex that many union members don't understand it. And Deere isn't willing to compromise on the details, says one source close to the talks. "I've never seen this so unbending," this person adds.

Deere's intractability is new. Its contract with the UAW, in 1991, went down without a hitch. The Moline (Ill.) company has won a reputation for partnership with the union on quality and productivity programs. And booming equipment markets mean Deere probably has at least two good financial years ahead. Smith Barney Shearson Inc. analyst Michael M. Levkovich expects the company to net \$600 million on sales of \$7.71 billion this year—more than triple the \$200 million it earned on sales of \$6.47 billion in 1993—and to do slightly better in 1995. The outlook is so robust that Deere hiked its dividend 10% during late summer.

The UAW, meanwhile, is in a tight spot. With a nasty strike dragging on at Caterpillar, the union risks appearing intransigent if it takes too bullheaded a stance with Deere. But the union also doesn't want to give Deere anything that Caterpillar might demand. And it must worry about contract talks with Deere rival Case Corp. in early 1995.

Given all that, nobody's counting on a strike. "The UAW can't cave easily," says University of California at Berkeley labor economist Harley Shaiken. And fall is the best time for the company to take a work stoppage: The harvest season is over, and orders for planting don't pick up until the winter. Still, Deere says it will listen to ideas from the union. That's one big difference from the Cat standoff: At Deere, they're still talking.

By Kevin Kelly in Chicago

DEERE VS. THE UAW

The issues that divide the two sides

WAGES Deere wants a wage system that would pay new hires 70% of current wages. The UAW opposes the idea.

BENEFITS The UAW is also against a Deere proposal to give lower benefits to new hires, who would have co-payments and deductibles in their health-care plan.

PRODUCTIVITY Deere wants pay tied directly to productivity gains. The UAW is not completely opposed but argues that Deere's plan would cut wages.

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SOFTWARE

BILL GATES IS RATTLING THE TELLER'S WINDOW

His bid for Quicken sends banks a message they can't ignore

William H. Gates III, multibillionaire chairman of Microsoft Corp., wants to manage your money. He also wants to process your checks and pay your bills, perhaps even arrange a loan.

To get there, Gates on Oct. 13 announced plans to pay a staggering \$1.5 billion—a 40% premium—for Intuit Inc., the maker of the best-selling Quicken personal-finance software. If the deal passes regulatory muster, Microsoft would instantly land the top spot in that tiny but fast-growing market. More important, Gates sees Intuit, coupled with an on-line service Microsoft is creating nicknamed Marvel, as a springboard for building a vast electronic marketplace for home-based financial transactions. Banking is just one piece. Eventually, Microsoft hopes to offer everything from mutual funds to brokerage services over its network.

The prospect has many banks spooked. For years, they have dabbled, mostly unsuccessfully, with remote banking. Now, Microsoft and Intuit have sent a jarring message: Get wired or get left behind. "If banks don't heed this wake-up call, they won't need another one," says William Randle, senior vice-president of Huntington Bancshares. "DINOSAURS." Microsoft and Intuit insist they want to work with banks—not shut them out. "We have no interest in being a bank," says Scott Cook, chairman of Intuit who, upon completion of the deal, will become Microsoft's electronic-commerce czar. But many bankers view Intuit's purchase last July of National Payment Clearinghouse Inc., an electronic bill-processor, as an encroachment on their territory. And Gates has made no secret of his view that banks are "dinosaurs."



WAKE-UP CALL: Rose finds Quicken "so simple to use"

What's at stake? Lots. In the brave new world of electronic commerce, the companies that own the transaction infrastructure will be able to charge a fee, much as banks do today with automated teller machines. That could be lucrative. Transaction-processing services today account for as much as 25% of noninterest income for banks, figures Richard K. Crone, an electronic-banking expert at KPMG Peat Marwick.

It's no wonder banks are on the defensive. Ten years ago, they processed

90% of all bank-card transactions, as Visa and MasterCard, says C. Today, 70% of those transactions are processed by nonbanks such as Data Resources Inc. If Microsoft and other interlopers become electronic takers, banks could become mere mortuaries for deposits—"money mortuaries," words of Huntington's Randle.

Even more worrisome, banks could lose the all-important direct link to customers that lets them hawk profit services. Straightforwardness is the "It's so simple to use," says San Francisco entrepreneur Alice Rose. When customers such as Rose turn their PCs to do their banking, the names that jump out at them are likely to be Microsoft and Quicken. "We would like to be the customers' primary provider of financial services—but Microsoft would like that, too," says Bruce A. Luedtke, vice-president in alternative-delivery systems at Banc One Corp. Adds William Anderson, president and chief executive officer of Block Financial Corp., a unit of H&R Block Inc.: "Gates believes, in the end, they will be his customers."

HEAD START. Anderson figures this move works to his advantage. Block, which owns the CompuServe on-line service, is pursuing a "bank-friendly" strategy, letting banks customize and resell its Managing Your Money software program. That approach has won Block such powerful allies as Visa U.S.A. Inc.—and potentially, its 600-member banks—as well as Interactive Transaction Partners, Electronic Data Systems, France Telecom, and U.S. West venture. Still, Quicken has six million customers—six times as many as its nearest rival.

Some financial institutions figure mighty Microsoft would be a good partner. And for now, Microsoft needs access to the banks' vast customer base. That means it will have to share profits,

says Joseph S. Pendleton III, senior vice-president of electronic banking at Meridian Bank Inc. Meanwhile, some banks are racing ahead with new software of their own. Says Pendleton, "Not all dinosaurs roll over and die. Some of 'em can run real fast and bite the hell out of you."

By Amy Corbin and Kelley Holman in New York, bureau reporter

BANKING'S NEW PLAYERS

Software companies are allying with banks to sell home banking

BLOCK FINANCIAL This H&R Block unit owns Managing Your Money personal-finance software and CompuServe. Provides electronic-banking services for Visa member banks.

COMPUTER ASSOCIATES Sells CA-Simply Money software. In discussions to market the personal-finance package through banking partners to on-line retail customers.

MICROSOFT Initial banking partners include First National Bank of Chicago, Michigan National Bank, and U.S. Bank of Oregon. With Intuit, it gets Quicken software and NPCI, an electronic bill-payer.

PRODIGY Teaming up with Meridian Bank and others to offer PC-based home banking via its electronic-information service.

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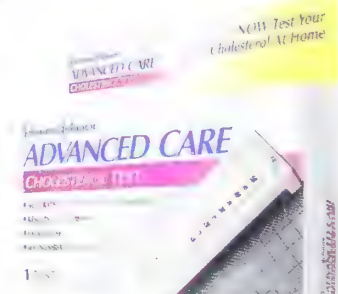
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PEOPLE

LOOSE LIPS SINK STOCK PRICES

Did Kodak investors overreact to a top exec's leaked memo?

Call it the \$1.1 billion memo. That's how much the market capitalization of Eastman Kodak Co. dropped in a two-day stock plunge in mid-October, following the leak of an internal memo from Leo J. "Jack" Thomas, Kodak's top operating executive.

Thomas warned managers that the company was falling short of profit targets and dictated draconian cost-cutting. But did the missive warrant such a severe reaction? Within Kodak, Thomas is famed for his forceful memos, which he often circulates to hundreds of managers. Several previous Thomas blasts have been made public. "People have told Jack that these things are bound to leak, but he doesn't seem to care," says one former Kodak executive.

THE HEAT IS ON. Kodak insiders insist that Thomas' latest memo is less interesting than it seems. They say fourth-quarter cuts have been standard practice in recent years, as managers scrambled to meet annual targets. Still, most earlier cutbacks were at a divisional level, while Thomas' missive was delivered to managers companywide. And this time his remedies seem more severe: slashing fourth-quarter travel and entertainment budgets in half, banning personal computer purchases, and paring research and development.

Most analysts don't believe that Thomas' memo indicates a serious profit shortfall at Kodak, which they expect to earn about \$255 million in the fourth quarter. More likely, Thomas is feeling heat from new Chief Executive George M. C. Fisher. Insiders say Fisher has publicly berated divisional heads who suggested they might fall short of forecasts. Thomas, who has headed the core imaging group through the last three years of turmoil, may be trying extra hard to show his new boss that he can be as tough as is necessary.

By Mark Maremont in Boston



KODAK'S THOMAS

COMMENTARY

By Mark Lewyn

THE PHONY ARGUMENT FROM THE BABY BELLS

Dover, N. J., population 14,849, seems an unlikely intersection on the Information Superhighway. But its local phone company is embarking on a high-tech venture that may decide who foots the estimated \$400 billion tab for rewiring America.

The issue was joined last July, when the Federal Communications Commis-

Their rationale: Everyone stands to benefit from access to a state-of-the-art network. Not coincidentally, that approach would also cut the cost of the Bells' new services.

But the other side—an unlikely coalition of cable companies, consumer groups, and some long-distance phone companies—makes a more

compelling case. It argues that those who sign up for the extras should pay more, just as they do for such services as Caller ID.

Why? The fact is that existing capacity is enough for most phone customers. Even if everyone does benefit from an upgraded network, it would still be a much sounder idea to have only users of



BABY BELLS AND WHISTLES: Installing fiber optics

sion—in an unprecedented move—allowed Bell Atlantic Corp. to compete against a local cable company by building an interactive video network in Dover that could offer everything from video telephones to movies on demand. But the FCC didn't confront a crucial question: Who should finance the video dial-tone (VDT) project? Every local phone customer or just video-service users?

SIDESTEPPING. On Oct. 20, the FCC is slated to take up a raft of VDT issues, but is likely only to begin studying the financing question. That's unfortunate, because how it rules could affect how quickly exotic new services become available. So it's vital that the FCC and the states set some rules soon. "This is the single biggest consumer pocketbook issue the agency will face over the next few years," says Bradley Stillman, legislative counsel for the Consumer Federation of America.

Not surprisingly, the Baby Bells argue that everyone should bear some of the huge cost of installing new fiber lines and other equipment.

new services pay for them. This would force the phone companies to enter hot new VDT markets the old-fashioned way—through investment rather than through milking their regulated monopolies.

Such an approach is also the best way to prevent consumers from being gouged. Local phone companies argue that government price caps already protect customers, but not all phone carriers are subject to such rules. If all customers pay for new video services, the average cost of basic monthly phone service will increase 14%—to \$21—by 2000, the Consumer Federation claims. If only users pay, however, the monthly rate will actually fall 25%, to \$13.40.

The real solution is to allow full competition in local phone service, making cross-subsidies foolhardy. But until that happens, phone companies shouldn't be free to use their monopolies to fund joy rides on the Info Highway.

Lewyn covers communications policy from Washington.



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EDITED BY KEITH H. HAMMONDS

DID NASDAQ GO UNDER THE COUNTER?

THE TRUSTBUSTERS SURE ARE busy. The Justice Dept.'s latest probe is an investigation into allegations that traders in the over-the-counter stock market are fixing prices. Their concern: Investors may be getting burned because market makers use the NASDAQ trading system to inflate the spread between the bid and asked price of stocks. A larger spread means fatter profits for the brokers. NASDAQ trading practices were questioned in a May study by two professors who suggested that collusion might explain the wide gap—at least 25¢ per share—between the bid and the asked prices of stocks. A NASDAQ spokesman said allegations of

collusion are unfounded. In early October, Justice confirmed that it also is investigating possible antitrust violations by the auto industry in its dealings with car-rental companies and in the way cars are priced.

MA BELL GETS A RINGY-DINGY

MA BELL IS ON A ROLL. ON Oct. 18, the Malcolm Baldrige National Quality Award went to AT&T, making it the first to win the prize three times. AT&T Consumer Communications Services shared the service-sector award with GTE's telephone directories subsidiary, Wainwright Industries, which makes stamped and machined products, won for small business. Another coup: AT&T's Mesquite (Tex.) plant won Japan's Deming Prize for quality.

CLOSING BELL

ZEOS ZOOMS

Early October was kind to computer stocks. Apple Computer jumped. IBM surged. But none sizzled more than Zeos International. On Oct. 13 and 14, shares in the tiny mail-order house soared 43%, to \$5, on extraordinary volume. Zeos executives contend investors were picking up on favorable product reviews and anticipating quarterly results. In fact, Zeos eked out a third-quarter profit of \$426,000. But something more was in the works: On Oct. 17, Zeos announced it would sell out to chip and pc maker Micron Technology for about \$405 million in stock. Zeos shares didn't budge on the news.



MCI'S INFO LINE KEEPS AT&T HOT

MCI COMMUNICATIONS' LATEST marketing ploy has drawn AT&T's fire. In a complaint filed Oct. 19 with the Federal Communications Commission, AT&T says that MCI's service, 1-800-CALL-INFO, violates federal rules by charging callers 75¢ for directory assistance. AT&T has asked the FCC to rescind its approval of MCI's service, because "the pervasive spread of services like this may erode the public's trust." Of course, MCI's service also could help the No. 2 long-distance carrier grab a larger share of the \$1 billion that U.S. callers spend on directory calls each year.

UNCOLA 1, COCA-COLA 0

THE (RELATIVELY) LITTLE GUY won one. A Federal jury in Dallas awarded Dr Pepper/Seven-Up \$2.5 million on

HEADLINER

DAVID HALE'S BIOTECH BLUES

For Gensia Chairman David Hale, Oct. 18 was a heartbreaker. That day, Gensia announced that its Protara, a drug to prevent heart attacks during coronary bypasses, had failed clinical trials needed to win FDA approval. It was the latest in a string of late-stage biotech failures, and Wall Street stripped Gensia of half its market value. Says Hale: "I never dreamed that this could happen."

What's left for Gensia, which spent \$30 million on Protara's latest trial? Hale says it will search for partners that can fund research

on Protara for other indications. Meanwhile, sales of 26 generic injectable drugs will help revenues double this year, to \$65 million.



But those are low-margin products. Gensia needs approval for a product that mimics the effect of treadmill exercise for stress electrocardiograms. And on

Oct. 11, it struck a deal to develop and market a generic substitute for Pfizer's Procordia XL angina and hypertension treatment. That will bring in \$20 million, giving Gensia \$65 million cash—enough to take it through mid-1996.

By Larry Armstrong

Oct. 18 in a suit against Coca-Cola. Seven-Up had charged that Coke unfairly pressured some Coke/Seven-Up bottlers two years ago to drop Seven-Up in favor of its similarly flavored Sprite. Coca-Cola, which denies the allegations, said it will appeal the verdict. But the ruling could bolster a similar lawsuit Seven-Up has pending against Coca-Cola in a Texas state court.

SUPERSTRONG STEEL PRICES FROM JAPAN

WITH THE DOLLAR AT 100 YEN, the specter of Japanese steel imports hardly rattles America's booming steel belt the way it used to. That's why news that General Motors had agreed to purchase a small quantity of metal from Japan's Kawasaki Steel brought forth a collective yawn from U.S. steel suppliers. With the dollar so weak, Japan is now one of the

world's highest-cost steel producers and is therefore unlikely to bury U.S. producers with inexpensive imports. What's more, as Japan's economy recovers, steel prices should rise there, discouraging massive exports to U.S. With \$7 billion invested in a host of American ventures, Japanese steel companies would be hard-pressed to battle for Detroit's business without fighting with their own trading kin.

ET CETERA...

- H.J. Heinz beefed up its frozen foods, buying All American Gourmet for \$200 million.
- Booming TV sales helped Zenith Electronics post its first profit in 12 quarters.
- Fallout from the Syntex deal: Roche will cut 5,000 jobs, most in the U.S.
- Bondholders' suit against Host Marriott and its executives ended in a mistrial.



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ANOTHER FED HIKE? THE AYES MAY NOT HAVE IT

Wall Street's market mavens think they have it all figured out: The Federal Reserve is sure to raise interest rates by mid-November to keep inflation at bay. And with the economy still growing smartly, Fed watchers are betting the central bank will move again this winter, driving short-term rates a good percentage point above current levels.

All sounds plausible, but the pros may have it wrong. Though Fed officials voted unanimously to raise rates five times so far this year, the central bank's policymakers are now increasingly uncertain—as well as divided—about whether another rate hike may be warranted soon, according to Fed insiders. Even if the Federal Open Market Committee can struggle to a consensus to hike rates by its next meeting on Nov. 15, officials suggest it could be the last boost for quite a while.

GH CALL. Indeed, within the secretive Fed, the heated debate has erupted over the state of the economy. A group of inflation hawks—residential bank presidents Robert T. Parry of San Francisco, J. Alfred Broadus Jr. of Richmond, Jerry L. Jordan of Cleveland—want an immediate rate increase. They fear a pickup in oil sales, rising commodity prices, and tight industrial capacity portend an overheating economy and a coming inflationary surge unless the Fed moves decisively.

At the other end is Vice-Chairman Alan S. Blinder, who appears to be influencing thinking at the Fed since his arrival this summer. Blinder argues that past Fed tightenings haven't been felt yet and will eventually slow the economy. "I don't think we're behind the curve," he explains. "People sometimes forget there are long lags in monetary policy." Though he's taken his lumps in the press for being an inflation dove, within the central bank Blinder has a persuasive advocate of caution. "He has the intellectual capacity to move the center," says a hawkish insider.



GREENSPAN: *Oddly unsure*

Yet even without Blinder's urgings, many members of the FOMC seem more inclined to proceed carefully because, by their own admission, they are torn by mixed economic signals. Among those in the newly ambivalent camp is Fed Governor Lawrence B. Lindsey: "The decision on Nov. 15 won't be easy. My mind is more open than it usually is."

Even Fed Chairman Alan Greenspan, one of the shrewdest readers of the economic tea leaves, is described by one FOMC member as uncharacteristically unsure about the Fed's next

move. By one account, Greenspan came very close to pushing for a rate increase in mid-October but backed off in the face of government data showing inflation in check. Associates say Greenspan still vividly recalls how a big rate hike he engineered in 1987 preceded the stock market's crash. So he is mindful of the potential dangers of moving too aggressively.

MISSING NUMBERS. The FOMC last moved boldly on Aug. 16, when it rejected a quarter-point rate boost in favor of a half-point hike because the larger increase might, according to the minutes, reduce the need for further action "or possibly even avert that need entirely." When the FOMC met again on Sept. 27, according to witnesses, the inflation hawks pressed for a rate boost, but the majority countered that the economic evidence didn't justify it. A couple of members even advocated deferring a move for six months. Lacking a consensus, "we decided we wanted to look at more data," says Lindsey.

Of course, should economic statistics in the coming weeks produce clearer signs that the economy is stronger than expected, the Fed surely will halt its introspection and move at once to bump up rates again. But absent that compelling evidence, the Fed is unlikely to tighten as much or move as quickly as bond traders may think.

By Dean Foust

CAPITAL WRAPUP

GATT IMPERILED

The White House is growing nervous that a decision to delay a vote on a new world trade agreement until after the November election may turn the General Agreement on Tariffs and Trade into a dead duck on Capitol Hill. Free-trade critics are poring over the legislation searching for hidden deals. Angry inventors are mounting a campaign against a provision they claim will gut U.S. patent protections. And Republicans may renege on a pledge to hold a postelec-

tion vote if the Republicans score big. The outlook is particularly dicey in the Senate, where lawmakers already are bartering their GATT votes for pet bills. The session could turn into a "Christmas tree" extravaganza befitting the season.

WHITE HOUSE ETHICS

►The Clinton Administration is taking steps to prevent political appointees from poking into law-enforcement matters—conduct that was at the heart of this past summer's congres-

sional probe into the Whitewater affair. Administration officials maintain there was nothing improper about senior Treasury Dept. officials giving Whitewater briefings to White House aides. Just the same, new White House Counsel Abner S. Mikva would like to design several new procedures that can give the President "a heads-up" about potentially embarrassing legal problems without raising ethical red flags. Under the new system, an agency lawyer would deal only with White House lawyers, who would then tell the President.

JAPAN

THE JAPANESE ARE BACK —BUT THERE'S A DIFFERENCE

Their new wave of U.S. investing is geared to building clout in core industries

Gone are the days of Japanese manufacturers arriving in U.S. towns to build plants, create jobs, and put pressure on local rivals, right?

Maybe not. Although totals for this year aren't yet available, a new wave of direct Japanese investment in the U.S. could be building. Within the past couple of months, several big companies have announced plans to expand U.S. production (table). This could presage the first surge of Japanese investment since the late 1980s, when Japan's "bubble" economy reached its headiest heights. Once the bubble burst, in 1990, the tide of Japanese money washing over the U.S. began to ebb.

The emerging boomlet isn't a reprise of the earlier splurge on "trophies" in real estate, Van Gogh paintings, or Hollywood studios. The Japanese investments also are smaller than the \$1 billion-plus acquisitions that Europeans have been making—

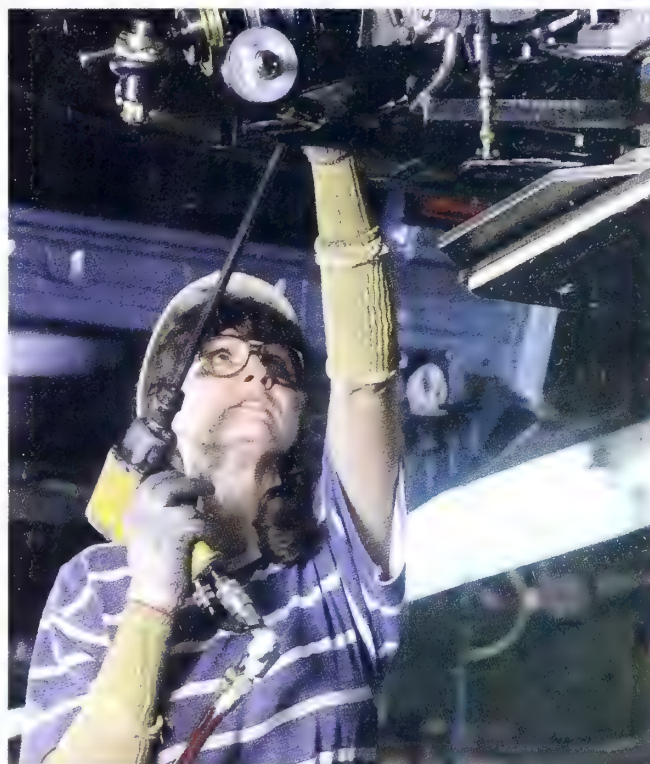
KENTUCKY HOME:

Toyota will build more cars stateside than it imports from Japan

in pharmaceuticals, for example. Although not big or flashy, Japan's new investments are focused on building competitive clout in such core industries as autos, semiconductors, electronics, and office products. That sort of investment "is coming back," says Kiyohiko Nanao, economic minister at the Japanese Embassy in Washington. "It will continue to grow."

NIFTY NAFTA. Japanese executives cite several reasons: the North American Free Trade Agreement, a pickup in the U.S. economy, persistent trade friction, and the stronger yen—*endaka* in Japanese—which makes investing in the U.S. and paying American workers cheaper than ever. The beginning of a pickup in Japan's economy doesn't hurt, either.

Take Toshiba Corp., which announced in early October it would expand TV production at its Lebanon (Tenn.) plant by more than 40%, to 2 million sets a year, by early 1997. Toshiba didn't say how much it would spend, but estimates are about \$20 million. A big consideration



Japan's New Investments

COMPANY	PROJECT	COST IN MILLIONS
TOYOTA	Adding to Kentucky auto assembly plant	\$900
MITSUBISHI MATERIALS	Building new silicon wafer plant in Oregon	240
HONDA	Boosting capacity at Ohio factories	200
NEC	Expanding California semiconductor plant	50
RICOH	Doubling of Georgia thermal paper plant	30

DATA: BUSINESS WEEK

is that NAFTA may be extended to Latin American countries. "Our long-term view is of an expanded market in the Americas based on NAFTA," says Toshiba Executive Vice-President Yoshihiko Wakumoto. What's more, he says, the U.S. has proceeded further along the

thing from factories to software joint ventures.

Having a grasp of exactly what customers want is driving semiconductor giant NEC Corp. to devote \$50 million start making advanced 64-megabit memory chips at its Roseville (Calif.) plant

Information Superhighway than any other nation. Toshiba reckons that to fuel demand for its especially the big models—with 8-inch screens or larger—at which the company excels.

Lower manufacturing wages and land costs in America are a key attraction. That's partly why Ricoh Co. recently decided to spend \$10 million to start making thermal paper products near Atlanta. Building the factory there will cost 30% less than in Japan, says Koji Inoue, a managing director at Ricoh.

HIGHER TECH. But Ricoh also simply needs to be closer to its customers in the huge U.S. market, and that goes for the copiers it makes, too. In fact, as the U.S. copier business goes digital and merges with the printer market, it will be more important for Ricoh to increase production and research in America. Inoue says Ricoh will invest "huge amounts" in the U.S.—on everything from factories to software joint ventures.

is the first time the company will make such a sophisticated product in the U.S. "We need to start advanced production overseas to meet the demands of our customers," says Hajime Imai, NEC's semiconductor chief. Even there's Toyota Motor Co., whose million-dollar expansion of its Georgetown (Ky.) plant is the biggest of this year's Japanese investments in America, aimed at increasing local content—boosting engine production and designing a new model called the Avalon to be made here—this plan has been in the works for years, says Toshiaki Taguchi, a Toyota board director. "This just happened

the latest influx of Japanese investment has grown three times that of American companies in Japan

coincide with growing trade friction in Japan," he says. Significantly, Toyota's total \$3.6 billion manufacturing investment will allow it to assemble and sell more cars in the U.S. than it imports from Japan. This greatly reduces its vulnerability to Japanese retaliation that the Clinton administration is threatening in autos. Even though Japan's latest investments are modest in size, they are not entirely without controversy. On Oct. 1, the congressional Office of Technology Assessment issued results of a two-year study concluding that Japanese investment in the U.S. has grown to three times that of American investment in Japan. It's "an imbalance deeply rooted in diverging systems of corporate management and financing," said Sen. John D. Rockefeller IV (D-W. Va.), who released the report. The study also found Japan's investments suck in more imports of components and capital goods than Europe's and that Japanese don't do enough research and development in the U.S. even if the new investments help what Japanese diplomats call "mutual dependency" between the two countries. They also may guarantee a steady flow of political friction.

Robert Neff, with Larry Holyoke in Kyoto and Douglas Harbrecht in England

EUROPE

THE COMING BATTLE OF THE CHANNEL

High-speed trains will spark a slugfest with planes and ferries

More people fly between London and Paris than any other international air route—3.7 million last year. But come Nov. 14, there'll be some stiff new competition for the 40-minute hop. That's when, 18 months late, trains will start hauling passengers through the English Channel tunnel. Dubbed Eurostar, the luxurious, 185 mph clones of France's TGV trains will swish from downtown London to downtown Paris in three hours. That's about the same time as many plane trips, including taxi rides and airport hassle.

Yet rail promoters and Eurotunnel stockholders who see a prosperous new era unfolding for high-speed trains may be in for a rude surprise. The coming battle of the Channel is likely to be nasty, as trains, planes, and ferries juggle fares and step up marketing to woo passengers. Indeed, Europe's biggest infrastructure project since Euro Disneyland could face a similar unhappy fate—low traffic and big losses.

FULL STRIDE. Two-thirds of cross-Channel passengers are British. Unlike France's center-city lifestyle, which has made the TGV a huge success, London's commuter culture means airports are more convenient for many suburbanites than downtown Waterloo train station. "People won't come into town if they're going to Paris for the day," says Nick Cunningham, an airline analyst with Barclays de Zoete Wedd Ltd. in London. And airlines offer 60 London-Paris flights a day, vs. only a planned 15 train trips.

Channel trains are adding huge capacity that will be hard to fill profitably. Including London-Brussels service that also starts on Nov. 14, the 30 Eurostar trains will offer more than 17 million seats a year when they hit full stride, probably next summer. That's almost quadruple current air traffic on the two routes. Tunnel shuttles will also carry cars, competing with ferries.

Airlines are already reacting. British Airways PLC, which carries 47% of London-Paris air traffic, has just spent \$115 million to widen seats, add airport lounges, and offer telephone check-in for business travelers. British Midland has launched a five-ticket Europass with a 40% discount.

Trains will undercut air fares, at least to start. A first-class Paris-London round-trip will cost \$310, including a meal. Business class on BA and Air France typically costs \$390. Trains will make only two daily round-trips on each of the two Continental routes at first, rising gradually to 15 on each. Although



HIGH SPEED, LOW FARES: Will any carriers make money?

Brussels is a modest market, planners see it as a hub for German and Dutch passengers.

Shareholders of Eurotunnel, the channel's operator, are eager for that long-delayed revenue flow. Construction delays and cost overruns that nearly doubled the project's price to \$14 billion forced a painful financial restructuring last May. But Eurotunnel announced on Oct. 17 that it may run out of cash next year. It's counting on its 220 banks for new loans to meet \$900 million in annual interest payments.

But to fill all those boats, trains, and planes, hordes of Parisians will have to shop at Harrods while half of London visits the Louvre. That may be too much to ask.

By Stewart Toy in Paris, with Heidi Dawley in London and Patrick Oster in Brussels

GERMANY

NOT WHAT THE DOCTOR ORDERED

Kohl's slim majority means his economic plan may get scrapped

As Germany goes, so goes Europe—and all the world wants from Germany right now is that it keep Europe's economy firmly on a growth track. The formula requires low interest rates, shrinking budget deficits, and an attack on Germany's thick web of regulation. Chancellor Helmut Kohl was supposed to deliver all of these things, which is why the financial markets were so relieved at his reelection on Oct. 16.

However, his victory may produce just the opposite. The trouble is Kohl's narrow 10-seat majority in the Bundestag. The chancellor insists that the margin is "big enough to govern with," which is technically true. But Kohl will have to make compromises that he didn't even need to consider with the last legislature, where his party had a 134-seat margin.

Bundesbank President Hans Tietmeyer issued a stern warning the day after the election that Germany must stay with its economic plan. But Kohl's power has been so diluted that his rival, Social Democratic Party (SPD) leader Rudolf Scharping, is already boasting that he will "be in office in 1998—or sooner." Scharping's party now has enough legislative clout to turn Kohl into a lame duck long before the term is over.

BAD NEWS. Kohl, with an eye to his history-book profile, can be counted on to finish uniting Europe—for which decisive negotiations on European monetary and economic union are due in 1996—and to finish reunifying the two Germanys before stepping down in 1998. But other domestic policy goals are likely to go out the window.

That's bad news for business. With unit labor costs already on the rise again, companies need Bonn's help in the form of lower taxes and social-security levies. And if the government doesn't maintain fiscal discipline, rising inflation will put further pressure on wages, undoing the

progress business has made toward cost-cutting and downsizing (BW—Oct. 17).

But a seriously weakened Kohl administration can't afford to burn political capital by pushing for radical cuts in welfare spending, which costs on average more than \$8,600 per capita annually. Nor is a government with a small working majority likely to court unpopularity by attacking subsidies to such vocal groups as Bavarian farmers or coal miners in the Ruhr. "Fiscal austerity doesn't fit into this agenda," says Thomas Mayer, chief economist at Goldman, Sachs & Co. in Frankfurt.

The risk is that the new government

will not just fail to reduce public spending but will allow it to rise faster. Private economists forecast that federal spending could increase by 5% or more in current-market terms, far more than the 3% target rate for inflation. Spending that Kohl set earlier this year. Under such a scenario, instead of coming into rough balance by 1998 as Kohl formerly promised, Germany's \$87 billion public-sector deficit would stay hefty 3.5% of gross national product. **NEW MILITANCY.** Kohl already faces rising populist pressure and labor militancy. Unions, encouraged by Kohl's weakened mandate and trying to compensate for two years of concessions, are making substantial pay demands for their contracts. IG Metall, Germany's largest union, is pressing for a 6% raise for more than 3 million members. Settlements could wind up in the 3%-to-3.5% range, enough to boost costs after two years of flat or declining real wages.

Meanwhile, Kohl has little muscle to push through anti-inflationary legislation. His Free Democratic Party (FDP) coalition allies lost more than 30 Bundestag seats and were booted out of three more state parliaments. That means that on key issues, the SPD's Scharping can drum up a two-thirds majority in the upper house to block any measure passed in the Bundestag.

The first spat could come soon. Kohl will present his budget early in the Bundestag session starting on Nov. 1. Among the measures held over from the last session is a government proposal to limit employment benefits to five years. The states hate it because once federal unemployment insurance runs out, recipients are eligible for more tested welfare—with the state picking up the tab.

"Kohl will have to be kind to the opposition from now on," says Michael Baer, senior vice president of Bank Julius Bär & Co. in London. Indeed, Kohl might have to be so kind that his government will look more like the "grand coalition" that Kohl always swore he'd never lead. Once market watchers realize what such a compromise means for German business and Europe's economy, their initial relief at Kohl's win could turn to dismay.

By John Templeman in Bonn

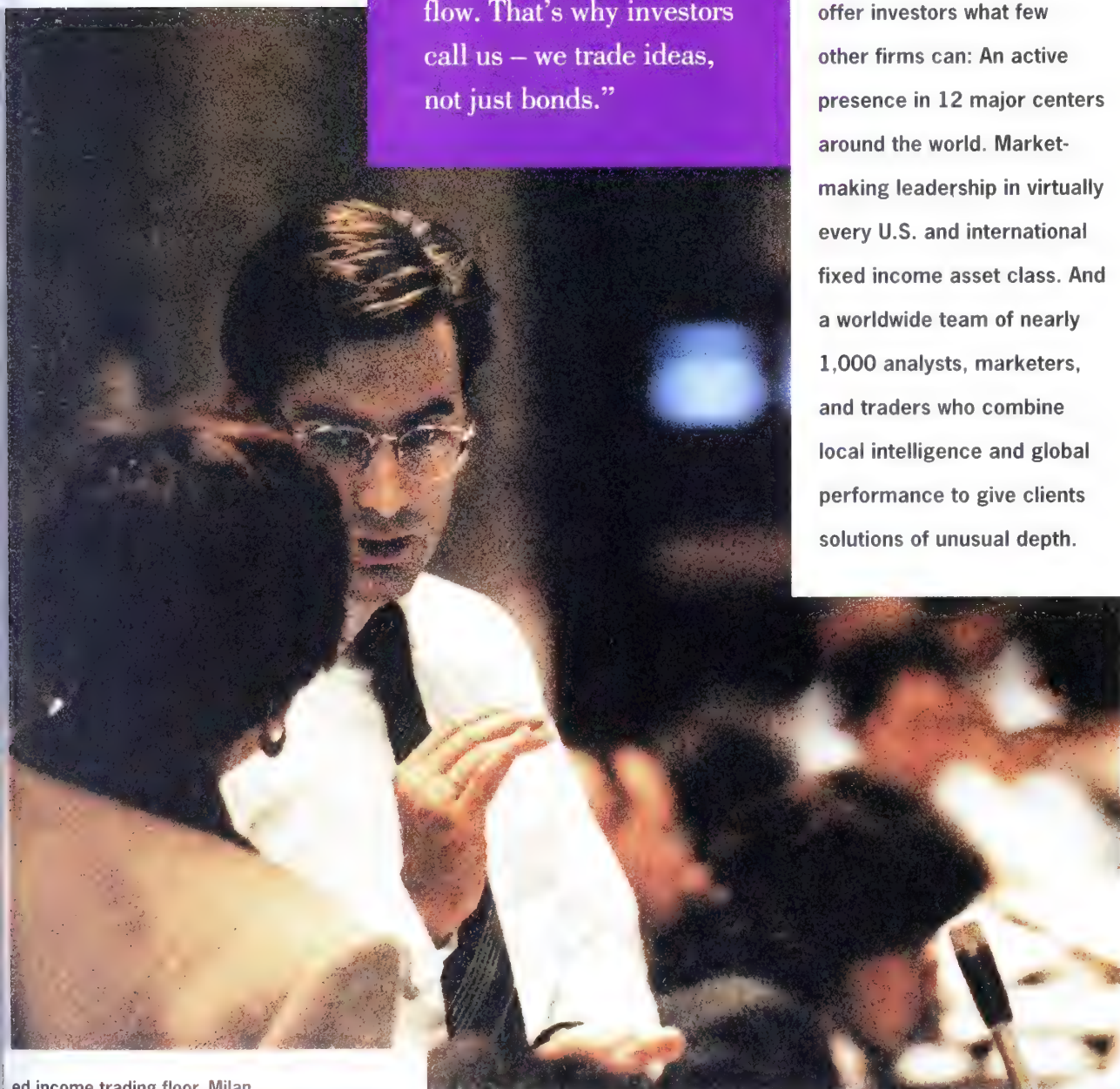


WEAK HAND The risk is that the new government will let public spending rise and cave in on union wage demands

Depth

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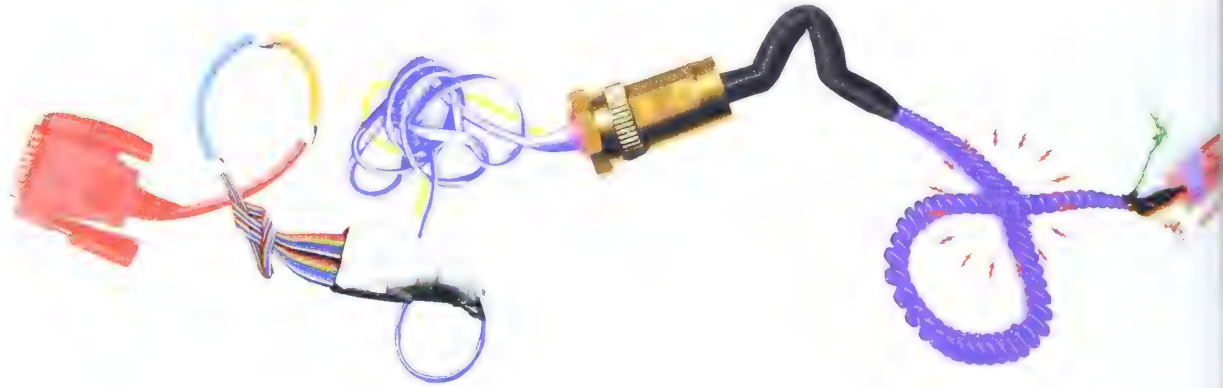
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JPMorgan

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There's nothing simple about having a communications network that's patched together by a collection of different companies from around the globe, each with their own technologies and their own way of doing things. Common sense suggests it would be better to have *one* global company responsible for managing your network. And that's exactly what you get with the IBM Global Network. Others may offer a "single point of contact"—but if you ask for something like global E-mail, they're likely to tell you their affiliates in Buenos Aires or Budapest aren't on line yet. Assuming they even *have* affiliates in those places. But the IBM Global Network has 5,000 network professionals and provides access to more than 90 countries. Now. So you can get a head start on the high-speed networking that'll make it seem like everyone in your corporation is working in the same office. Questions? Call us in Europe at 33-1-4905-9879. In Asia at 81 3 5644 2225. In the U.S. and Canada at 800 455-5056. In Latin America at 813 878-5403. And you'll get some straight answers about international network communications.

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EN ROUTE: Federal Express is boosting flights to the Philippines.

THE PHILIPPINES

SHAKING MANILA OUT OF ITS SLUMBER

The strong hand of Ramos forges a competitive economy

At Malacañang Palace, President Fidel Ramos eagerly listens to a presentation by representatives from a U.S. multinational who want to build a power-generation project. The executives describe the maze of bureaucracy they have endured over several months. When they finish, Ramos turns to his Energy Secretary, Francisco Viray. "Can we accelerate this?" Ramos asks.

Since taking office in 1992, the general-turned-politician has been making similar demands of Filipinos. Ramos, 64, has pressed them to approve reforms necessary to make the Philippines competitive. He has eased an energy crisis, busted monopolies, and removed restrictions on foreign investment. As a result, the Philippines could be shedding its status as the sick man of Asia.

MORE CONFIDENCE. Ramos is also trying to redefine relations with the U.S., which have been cool ever since Manila kicked the Americans out of Subic Naval Base and Clark Air Base in 1991. With President Clinton scheduled to start his visit to the Philippines on Nov. 12, Ra-

mos says he wants to forge a more mature relationship built on trade rather than military security.

At first, it was mostly Taiwanese and Japanese investors who placed new bets on Ramos. But now, Americans are showing an uptick in confidence as well. Among the companies opening or expanding their Philippine operations are Intel, Enron, Federal Express, Caltex, Nynex, Procter & Gamble, and Citibank.

With foreigners now allowed to own as much as 100% of local companies, direct foreign investment increased 160%, to \$585 million, in the first four months of this year.

The new receptivity to foreign investment has had dramatic results. A year ago, Manila suffered from eight hours of brownouts a day. But Ramos patched up old power plants and

allowed private companies to build and finance key projects. Enron Power Development, and others have completed power projects in the past year. "When Ramos promised no brownouts by December, 1993, people laughed," says Thomas J. Leber, president and general manager of Wyeth Philippines, a U.S. pharmaceutical company. In fact, he delivered.

The financial markets are another indicator of bullish sentiment. In the past, companies needed to curry favor with officials to get bank

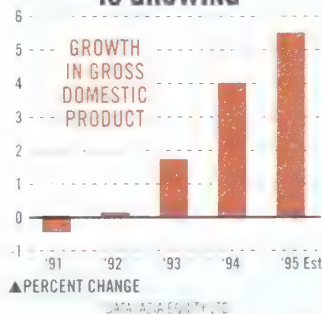
loans. Now, they are opting to raise funds through the growing stock market or through international debt placements. Philippine companies raised a hefty \$670 million on international capital markets last year. "The stock market is far bigger and far better than the past," says Matthew S. Sutherland, research director of Philippine Asia-Unity Securities Inc.

RUSHING TO LIST. A key part of the reforms is forcing change on the family firms that have long dominated the economy. Philippine Long Distance Telephone, controlled by the Cojuangco family, has a lock on the market for decades. Last year, Ramos opened the industry to competition. PLDT responded by cutting rates and improving service. Foreign companies are moving in on its turf. On Sept. 20, Nynex signed a memorandum of understanding to buy 25% of a local telecom company and spend \$100 million over the next four years. A

national agreement is scheduled to be signed mid-November.

Many leading family firms are rushing to list their companies on the local stock market to raise the funds needed to become competitive. Others are trying to make the transition into high-tech businesses. J. Concepcion III, 36-year-old president and CEO of powerful RFM Corp., a \$280 million food-pr-

THE PHILIPPINE ECONOMY IS GROWING



manufacturing company, has over three initial public offerings this year to raise money to diversify into the semiconductor industry. Recently, he bought Pacific Semiconductors Inc., a company that he expects to make \$100 million next year. "It is our general challenge to become globally competitive," he says. "I don't have a choice."

That change in thinking has led more Americans to try out the Philippines. B. Fuller Inc., a \$1 billion U.S. adhesive and sealant company, bought an 80% share of a local chemical operation in 1992. Fuller, which is investing \$60 million in the Philippines, is building a factory near Manila to produce adhesives for the regional market. "I have a great deal of faith in what Ramos is doing," says David J. Elliott, president of B. Fuller (Philippines) Inc.

Of course, the sums being invested are modest compared with the billions being poured into China. But some U.S. corporations are aggressively expanding. In the Philippines, Manufacturing Inc. is launching a \$200 million expansion at its memory chip and microprocessor plant in Manila over the next five years. Avon is using the Philippines as a manufacturing hub. P&G is building a \$100 million factory to make detergents. Caltex spent \$140 million on environmental remediation projects over the past two years.

THE PARTY. All the good news, however, doesn't mean that the Philippines will become an Asian Tiger overnight. About half the population of 70 million still lives below the poverty line, and the country has to make up for years of decay. Moreover, Ramos has to tackle some long-standing problems. For example, corrupt bureaucrats must sign off on licenses and permits, often demand money before they expedite approvals.

But signs of a comeback are clearly visible. Glass and steel high-rises are going up in Manila's business districts—a welcome contrast to the city's sprawling shantytowns. The government estimates that foreign investment in Subic Bay and other places has helped create 93,000 new jobs this year. "Filipinos are optimistic and hopeful for the first time in years," observes U.S. Ambassador John D. Negroponte. A lot of work remains to be done. Ramos has traveled throughout Asia, Europe, the U.S., and recently the Middle East to pump up interest in the Philippines. If he can pull off a successful Clinton visit and get the American connection back on track, that, too, could help the Philippines finally join the party in the world's most dynamic region.

by Teresa Albor and Joyce Barnathan in Manila

THE PHILIPPINES' IMPASSIONED PITCHMAN

On a flight from Manila to Bacolod in the central Philippines, President Fidel Ramos spoke to BUSINESS WEEK Hong Kong Bureau Chief Joyce Barnathan and Manila Correspondent Teresa Albor about U.S.-Philippine relations and the upcoming Asia-Pacific Economic Cooperation (APEC) summit:

Q: What is your key message to President Clinton and the American people?

A: Trade, not aid. Let's intensify our economic cooperation. I'm talking about investment, trade, tourism, and technology transfer. To the people in the U.S., we are the only country in APEC that has had a commercial, historical, cultural, and even political connection to the U.S.

Q: Would a prosperous Philippines add to U.S. clout in the region?



WOOLING AMERICA

"Trade, not aid. Let's intensify our economic cooperation [with] investment, trade, tourism, and technology transfer."

— President Fidel Ramos

A: It could be a benefit, but I'm not saying that we again will be the pushers or the spokesmen for the U.S. No, we are into a completely open and free-market kind of system. In our part of the world, it's really the Philippines that is carrying on with its economic programs and social reforms under a working democratic framework more akin to the U.S. style.

Q: We hear you have a particularly close relationship with Bill Clinton.

A: We write each other quite often. He writes "Dear Eddie" and signs it "Bill." We exchange little gifts. I gave him cigars personalized with

his name on them, some Philippines 2000 golf balls, and some Cebu-made Timex watches.... He sent me a handwritten Christmas card.

Also, at the last APEC summit, I told him he had batted very hard for NAFTA. It was the eve of APEC, and GATT was pending. So I said: "Let's go for a triple play." You see, I spent five years in the U.S. in college; I picked up a lot of the culture. Among the rest of the others at APEC, I can communicate in that way with the President of the United States.

Q: Are you satisfied with the level of U.S. investment in the Philippines?

A: Four months ago, I inaugurated the Procter & Gamble plant, part of their expansion. We are seeing some big players come in. There are new investments in power generation. Federal Express is in. We're also seeing the banks come in. Tourism

people are coming in. For example, Days Inns.

Q: So then you are satisfied.

A: Not quite. There is so much more the U.S. could do. Consider that the Philippines is now a gateway [to Asia]. We are English-speaking. Our democratic system is well known to the Americans. We have the financial, banking, management, and computer services here, which you don't find in many countries. And we have the hubs that can service American exports. Lastly, we have a market of 67 million people, with investable incomes that are rising.

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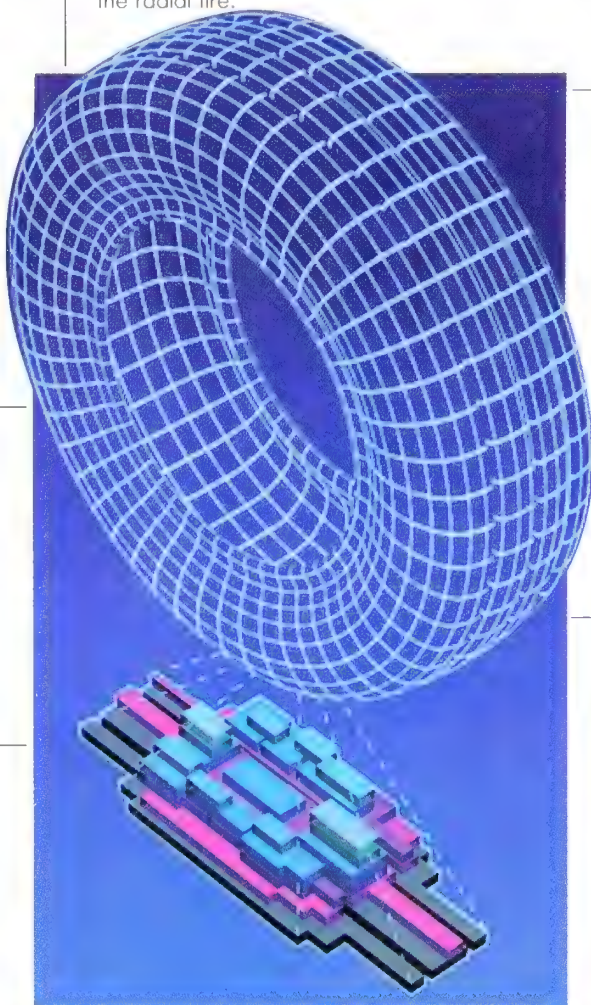
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EDITED BY STANLEY REED

THE RACE TO COME UP WITH A PEACE DIVIDEND

Little more than 48 hours after Israeli Prime Minister Yitzhak Rabin and Jordan's King Hussein announced a breakthrough agreement, they were reminded of just how treacherous the road to peace can be. Twenty-two people died when a suicide bomber, apparently from the Palestinian Islamic group Hamas, blew up a bus in central Tel Aviv on Oct. 19.

Abhorrent as the attack was, the peace process will go on. It should get a boost on Oct. 26, when President Bill Clinton presides over the signing of the Jordanian-Israeli peace treaty in the desert between the cities of Aqaba and Eilat.

Yet the crescendo of terrorist attacks inside Israel and the seeming powerlessness of Palestine Liberation Organization chief Yasser Arafat is increasing the risk of failure. The ruling Labor Party, which is clinging to a tiny majority in the Knesset, will now take even more heat from the hard-line Likud opposition, which has been bitterly critical of the pact with the PLO. In an attempt to halt the attacks, the harried Rabin is barring tens of thousands of Palestinian workers from going to their jobs in Israel. Unfortunately, this move will play into the hands of Hamas by worsening economic conditions in the West Bank and Gaza and ratcheting up tensions there.

DEAL-A-THON. To safeguard what has been achieved and give the talks a new momentum, Rabin and the Jordanians are pushing hard to show the region's war-weary people benefits from peace. The centerpiece of their efforts is a proposed \$10 billion development bank. Israeli Foreign Minister Shimon Peres and Jordan's Crown Prince Hassan are trying to sell the idea to the West and the gulf Arabs. Projects they foresee the bank funding include a \$1 billion joint Israeli-Jordanian port on the Red Sea, an \$800 million pipeline to sup-

ply Israel and Gaza with gas from Egypt, and multibillion-dollar desalinization projects.

The bank plan will be heavily promoted at a regional economic summit scheduled for the end of October in Casablanca. This extravaganza will feature an extraordinary array of political leaders, including the PLO's Arafat, U.S. Secretary of State Warren M. Christopher, and Egyptian President Hosni Mubarak.

The summit will also bring together dozens of Western Israeli, and Arab business leaders for what its backers hope will be deal-packed meetings. Corporate sponsors include

American Express, ENI, Asea Brown Boveri, and Archer Daniels Midland.

But whether Casablanca will produce more than an exotic photo opportunity isn't clear. There is some opposition to the proposed bank at the World Bank, which views it as a competing institution. The gulf Arabs, who are expected to cough up much of the capital, are pleading poverty. Development experts also argue that the region needs private investment not another bureaucratic financing agency.

Still, while \$10 billion may be overreaching, Clinton Administration officials seem to be buying into the idea of a regional economic institution. They see joint projects as a useful way to foster cooperation between Israel and its Arab neighbors. And the U.S. has a good track record as an international fund-raiser.

But they may have to move faster than they think. There is a growing sense, particularly in the West Bank and Gaza, that the peace process hasn't delivered much. If Rabin, Arafat, and Hussein don't produce some quick dividends, they are going to be severely tested.

By John Rossant in Rome, with Neal Sandler in Jerusalem and Amy Borrus in Washington



PARTNERS: King Hussein and Rabin

GLOBAL WRAPUP

SURPRISE RUSSIAN BANKER

► President Boris N. Yeltsin has backed off from his effort to force real change at the Russian Central Bank. Yeltsin had used the bank's disastrous management of the ruble to force the resignation of longtime foe Viktor Geraschenko as head of the central bank. To replace him, Yeltsin was said to have been considering such well-known reformers as former economics czar Yegor Gaidar and former Finance Minister Boris Federov.

Instead, Yeltsin named Tatyana Par-

amonova, 43, who was Geraschenko's No. 2. The Russian leader chose not to risk a fight with political opponents. Paramonova is respected by Western bankers but isn't thought to be a strong enough figure to enforce tough monetary policy to stabilize the ruble. Her appointment is a victory for Prime Minister Viktor Chernomyrdin, who doesn't mind printing money to keep subsidies flowing to industry and agriculture.

HOW REAL IS THE KOREA DEAL?

► The recently announced U.S. deal to stop North Korea's nuclear weap-

ons program could still founder. The North agreed to allow bitter rival South Korea to play a role in building two light-water nuclear reactors to replace Pyongyang's existing reactors. But the isolationist North could balk at letting in the estimated 2,000 South Korean engineers and technicians required to implement this program. Experts also are skeptical that North Korean leader Kim Jong-Il, who is expected to assume full power soon, will follow through on Pyongyang's promise to resume an official dialogue with Seoul.

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EDUCATION

TOTAL QUALITY MANAGEMENT: NOW, IT'S A CLASS ACT

Schools are borrowing business principles—and getting results

Heather Peart balances herself on a stool at a workbench in Brooklyn's George Westinghouse Vocational & Technical High School. Soldering iron in hand, the 17-year-old focuses intently as she melts strands of solder onto a circuit board from a Ricoh Corp. fax machine. She repeats the delicate task several times before deeming it perfect. "I have to do it so it looks clean and proper," she says. "Just like you'd want it to be if you were buying it."

With help from companies such as Ricoh, IBM, and Xerox, Peart and her Westinghouse classmates are participating in an educational experiment: learning—and using—Total Quality Management, the popular business technique. In their electronics classes, the students use TQM principles to finish re-

pairs well before deadlines and with few mistakes. Westinghouse also uses quality management tenets to improve attendance and parental involvement. The effort seems to be paying off: Since the schoolwide program began in 1990, Westinghouse's dropout rate has fallen from 12.9% to 2.1%. "The school, the student, industry in general—everybody wins with this program," says Ricoh Vice-President Wayne A. Mize. "This wraps a whole lot of things together that these kids can bring to any workplace."

Westinghouse is one of a small but growing number of schools that are turning to TQM in hopes of achieving educational reform. According to the Milwaukee-based American Society for Quality Control, the number of the na-

ALL BUSINESS: *Repairing Ricoh gear at Brooklyn's Westinghouse High*

tion's 15,500 public school districts using TQM for everything from increasing parental involvement to dealing with budget cuts grew to 127 in the last school year—from 87 the year before.

Now the federal government is seeking to promote much wider adoption of the concept, by developing a Baldridge Quality Award for education similar to the Commerce Dept. honor for quality in business. The school prize, to be issued for the first time in 1996, will recognize excellence in the hallmarks of TQM: constant improvement and better results, from higher test scores to lower dropout rates. Judges will look for evidence that students are benefiting not just that the school is teaching TQM principles. "It's a profound shift to emphasizing learning rather than teaching," says Curt W. Reimann, director for quality programs at Commerce's National Institute of Standards & Technology, which is developing the prize criteria.

"CONTINUOUS FEEDBACK." While there are obvious differences between businesses and schools, educators trying to adapt quality principles often use the same techniques and vocabulary—such as "customer satisfaction" and "brainstorming"—as their commercial counterparts. For example, schools in Redding, Calif., successfully use a TQM tactic known as a "run chart" that helps students visualize their progress. Fifth graders at Lassen View School use the method to plot their progress as they learn the locations of 100 cities around the globe. Says Donald B. Barber, the district psychologist: "Children become active participants in their learning."

Much the same happens at Westinghouse High. In keeping with TQM's emphasis on gathering data to identify and help solve problems, teachers and administrators monitor attendance and test scores to pinpoint problems, then use the information to brainstorm with students to figure out how to resolve truancy and classroom failures. Meanwhile, students in the Ricoh worksho-

How Westinghouse High Uses Some Common TQM Tools

SCATTER DIAGRAMS

Using drawings to illustrate the relationship between two variables, teachers show students how skipping homework leads to poor test grades. That helped lower the dropout rate to 2.1% from 12.9%.

BENCHMARKING

Using a survey approach developed by Xerox Corp., Westinghouse traced low PTA turnout to scheduling conflicts. Changing meeting times to accommodate parents boosted attendance by 17 times.

CAUSE-AND-EFFECT

Attendance records showed that some students were chronically late. So prompter students agreed to make wake-up calls to their tardy classmates to solve the problem.

NationsBank: Supporting Our Merger And Acquisition Advice With Capital And Performance.

This announcement appears as a matter of record only.

Compass Group PLC

Has Acquired

Canteen Corporation

From

Flagstar Companies, Inc.

The undersigned initiated this transaction, assisted in negotiations and served as financial advisor to Compass Group PLC

NationsBank

June 1994

This announcement appears as a matter of record only.

Compass Holdings, Inc.

\$230,000,000

Acquisition Facility

The undersigned funded and underwrote the U.S. bridge financing, together with the working capital and letter of credit facilities to enable Compass Group PLC to acquire Canteen Corporation.

NationsBank

June 1994

This announcement appears as a matter of record only.

Weyerhaeuser Real Estate Company

a subsidiary of

Weyerhaeuser Company

Has Sold the Assets and Operations of the

Homebuilding Division

of

Westminster Homes, Inc.

to

Washington Homes, Inc.

The undersigned initiated this transaction and served as financial advisor to Weyerhaeuser Real Estate Company

NationsBank

June 1994

This announcement appears as a matter of record only.



BEASLEY BROADCAST GROUP

Has Sold

KRTH-FM, Los Angeles

to

Infinity Broadcast Corp.

The undersigned acted as financial advisor to Beasley Broadcast Group

NationsBank Capital Markets, Inc.

NationsBank

February 1994

This announcement appears as a matter of record only.



BEASLEY BROADCAST GROUP

\$89,752,393

Interim Financing

Funding Provided by

NationsBank

The undersigned structured this transaction, arranged the financing and acted as financial advisor to Beasley Broadcast Group

NationsBank Capital Markets, Inc.

NationsBank

December 1993

This announcement appears as a matter of record only.

WG, INC.

A Corporation Formed by Management and Private Investors

Has Acquired

the Apparel Division of

Willcox & Gibbs, Inc.

The undersigned arranged the senior and subordinated financing, assisted in the private placement of preferred and common equity, assisted in negotiations and acted as financial advisor to WG, Inc.

NationsBank

June 1994

This announcement appears as a matter of record only.

Wilsons Supermarkets

Has Been Acquired By

HANNAFORD BROS. CO.

The undersigned initiated this transaction, assisted in negotiations and served as financial advisor to Wilsons Supermarkets

NationsBank

August 1994

This announcement appears as a matter of record only.

Calvin Gilmore

Has Sold a Majority Interest in Its Principal Assets to a Subsidiary of

INTERNATIONAL FAMILY ENTERTAINMENT, INC.

The undersigned initiated this transaction, assisted in negotiations and served as exclusive financial advisor to Calvin Gilmore Productions, Ltd.

NationsBank

December 1993

This announcement appears as a matter of record only.



Blessings Corporation

Has Acquired Controlling Interest in

Nacional de Envases Plasticos, S.A. de C.V.

Hermes Industrial, S.A. de C.V.

Mexicana de Tintas, S.A.

Plastihul, S.A. de C.V.

Vigo, S.C.

The undersigned served as financial advisor to Blessings Corporation in this transaction

NationsBank Capital Markets, Inc.

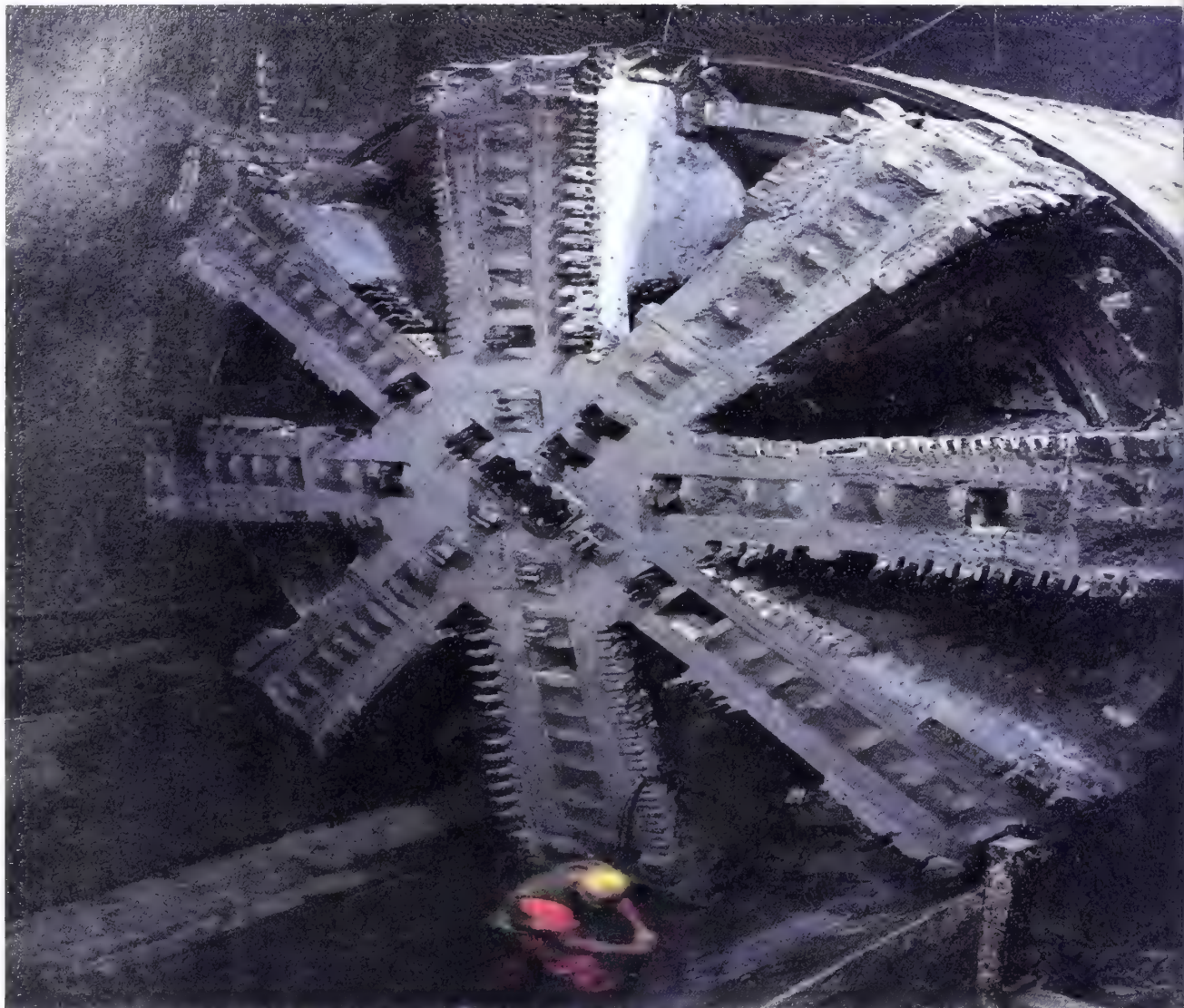
NationsBank

June 1994

NationsBank – a trusted financial advisor to successful corporations. Our people understand the unique financial and operating strategies of our clients and deliver value added solutions to assist them in meeting their objectives

NationsBank

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The Chimera Caterpillar—Able to chew through 15 feet of granite in 10m, this tungsten-studded, laser-guided earth-eater turned a 1,000-year dream into reality and concrete.

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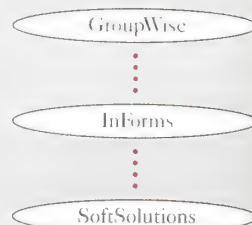
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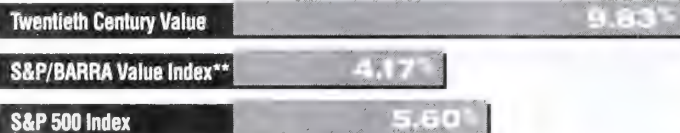
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** Source: Ibbotson Associates, Inc. ■ Data quoted represents past performance and assumes reinvestment of all distributions. Past performance is no guarantee of future results. Investment return and principal value will fluctuate, and redemption value may be more or less than original cost.

Social Issues

study TQM theory. As their counterparts in business do, they work in teams and identify their mistakes, such as misshapen solder on circuit boards. "They get continuous feedback from Ricoh," says Franklin P. Schargel, quality coordinator for the school. "They're constantly aware of customer satisfaction."

In adopting TQM, Westinghouse had to overcome resistance from the New York City Board of Education, which denied the school's request to buy TQM textbooks because they weren't on the approved list of texts. Determined administrators got Motorola Inc. to pay for the books. "The more hardened the system, as this one is, the stronger they have to be," says former Assistant Commerce Secretary Myron Tribus, who studied Westinghouse's initiative.

FEWER FIGHTS. It's worth the trouble to transform students into the kind of workers executives feared inner-city schools could no longer produce. As part of the effort to lower the dropout rate, teachers who volunteered to work overtime on a 1992 task force identified 14 students among Westinghouse's 1,600 who were failing every course. By the end of the school year, customized educational plans for each student and contracts outlining the responsibilities of students, parents, and teachers shrank that figure to 11. Although more than half the school's students come from single-parent families with incomes below the poverty line, parental involvement in the PTA has grown from 12 members in 1991 to 211 last year.

Not every school has had great success. The tiny rural district in Rappahannock, Va., has experimented with TQM for three years. Test scores haven't risen, nor has the small number of students going to college. Still, quality program surveys helped officials discover parents' top concern: School brawls. The district expanded its fleet and shortened the routes. The fights declined, and parental satisfaction tripled—a key development, given the system's growing competition with free religious private schools nearby. "We had to compete on a basis of something other than free tuition," says superintendent David M. Gangel. "And that's quality and customer satisfaction."

It's a lesson the Japanese, the leading practitioners of quality management, learned well. When Japan imported the techniques from the U.S. four decades ago, its factories were churning out standard products. TQM worked wonders there. Next comes the test of whether it can fix America's schools.

By Christina Del Valle in New York

PERFORMANCE THAT BEAT THE S&P 500!

NAIVE? INEXPERIENCED? IT WORKS FOR FRANK NEWMAN

The Beltway outsider is racking up impressive victories for Treasury

When Bank of America CFO Frank N. Newman got a call in December, 1992, urging him to leave San Francisco to become Treasury Under Secretary for Domestic Finance, he considered the credits and debits. "I'd have to leave a company where I enjoyed working and knew all the people and go to a place where I don't know anyone, where it was high-political, where it was hot in the summer and cold in the winter, and take a 10% pay cut," he recalls. "I said, 'Sure.'"

temporary insanity a legitimate plea at this point?"

Landing in Washington that February, Newman faced a frosty reception once he unpacked his box of ambitious proposals to overhaul banking laws. He knew congressional banking committees were renowned graveyards for banking-reform legislation, and that the banking community is split on several issues. And other financial services sectors—mutual funds, insurance, and consumer credit—op-

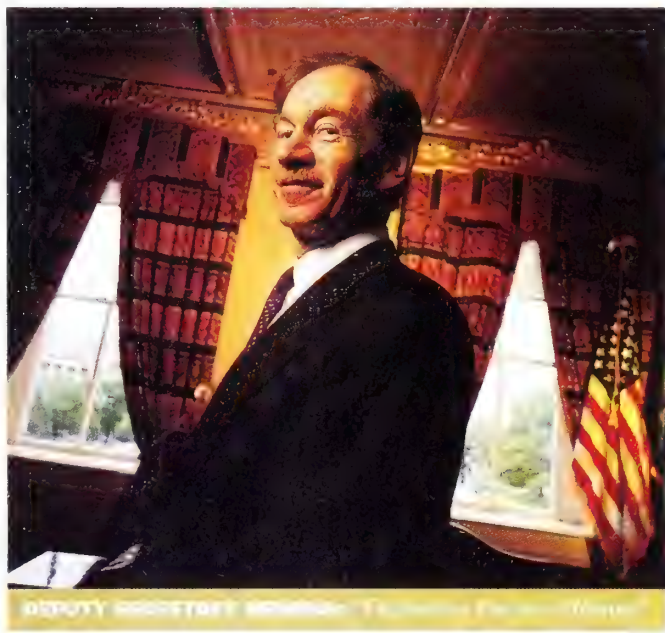
posed his plan to require them, like banks, to invest in local communities. Federal Reserve Board Chairman Alan Greenspan didn't cotton to the idea either. And when the Fed chief heard of Newman's proposal to clip the central bank's powers to oversee banks, he ticked strong objections to Congress. "There was a certain amount of political veto involved," says a Senate banking aide. Admits Newman: "Clearly, this is not one we count as a success."

He persevered. Now, regulatory reform is back on track, thanks to a compromise that would retain the Fed's full

authority over the large banks but allow the Treasury to oversee smaller ones, and interstate banking has passed. And Newman, 52, has bagged a promotion to the No. 2 job at Treasury: On Sept. 29, he replaced Roger C. Altman, who was forced to resign the job after admitting he had misled Congress on the Whitewater affair.

Despite his rocky start with Congress, Newman established a close relationship with Treasury Secretary Lloyd M. Bentsen. That, plus his legislative

ers, such as Altman and Richard G. Darman, who served under Ronald Reagan. Yet Newman's lack of political experience and ambition could be a plus. Altman, after all, can be faulted for spending too much time helping the White House out with high-profile, and highly charged, political issues: health-care reform, the North American Free Trade Agreement, and Whitewater damage control. Darman considered himself a tactical genius, but his legislative moves were undercut by an arrogance that



Frank N. Newman
Deputy Assistant Secretary

PREVIOUS JOBS

Under Secretary for Domestic Finance; Chief Financial Officer, BankAmerica; Chief Financial Officer, Wells Fargo

EDUCATION

Harvard BA in economics, 1963

ACCOMPLISHMENTS

Helped enact bills allowing interstate banking, promoting community development, cutting banking regulation, and reforming bankruptcy laws

HOBBIES

Classical music, skiing, hiking

record, won him the deputy job. Among the victories for which Newman can claim some credit: steering through Congress a bill to reduce abuses by bankrupt debtors, trimming bank regulatory paperwork and fees, and fully funding the Resolution Trust Corp. Notes Kenneth A. Guenther, top lobbyist for the Independent Bankers Assn. of America, which opposed Newman's push to expand interstate banking: "Three Republican Treasury Secretaries tried this and failed."

Now, Newman faces greater challenges in a job often filled by cunning insid-

made enemies in Congress. Newman, meanwhile, insists that "I enjoy working with legislators and testifying in hearings. It's an opportunity to have a discourse." A Treasury colleague explains: "Newman is definitely the un-Altman."

CLEVER STAGING. Even without knowing where all the skeletons are buried on Capitol Hill, Newman believes that his commonsense approach can work. Rather than shoving a massive bank-reform package down Congress' throat, "Frank recognized that there were some incremental changes that could go through and he was clever in figuring out how to



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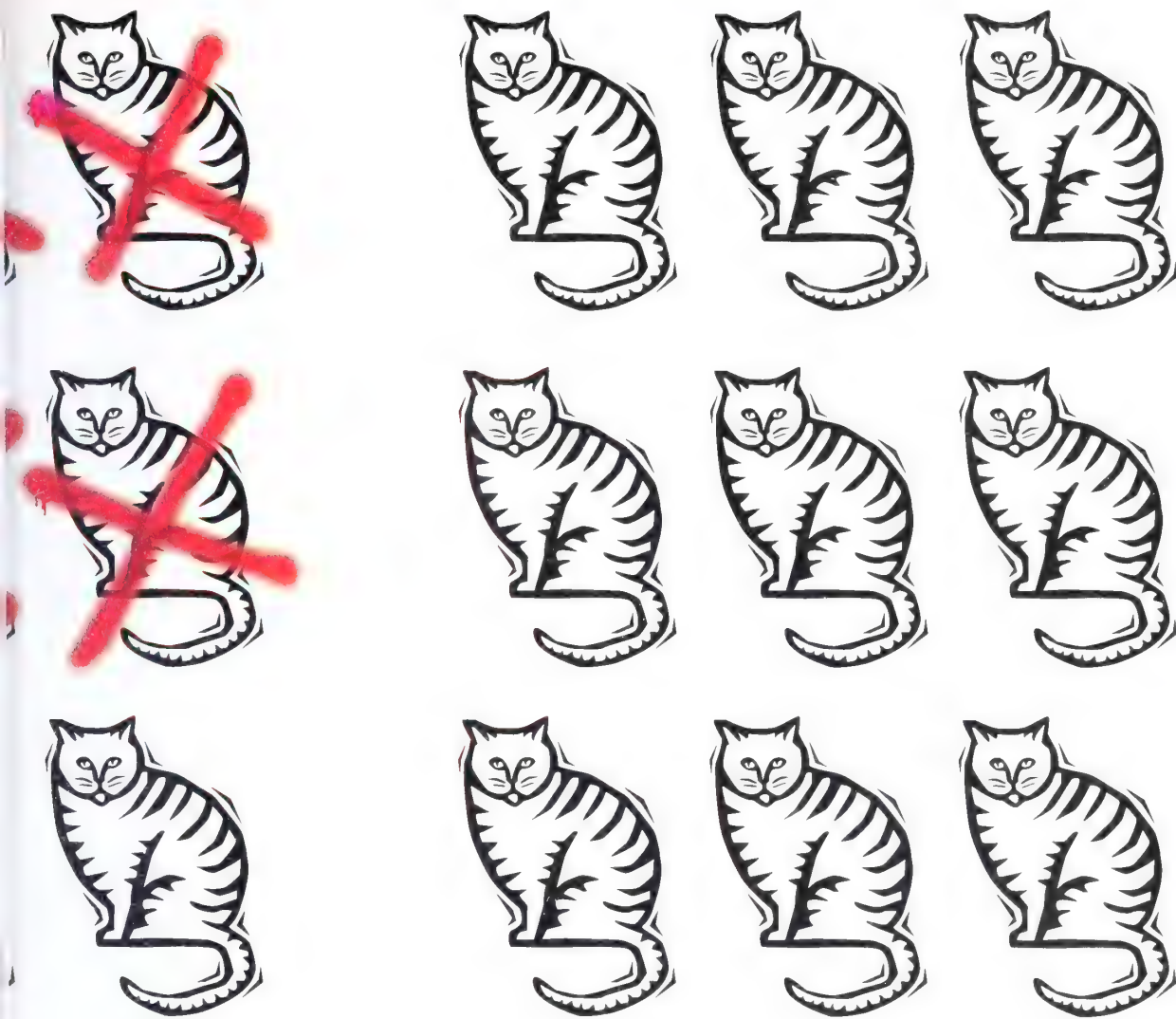
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Government

stake them," says Ellen Seidman, staffer at the National Economic Council. Newman also earns high marks from fellow bankers for thwarting legislation—such as the panicky reaction of the House to portfolio losses from derivatives. "He definitely took the lead in stalling some legislation that would have been very harmful," says Edward Yingling, the chief Washington lobbyist for the American Bankers Assn., who opposed the bill. Newman promised that he would study the issue.

WISH LIST. Newman's biggest hurdles are still to come. Congress will take a far more Republican hue after the Nov. 8 elections, making it harder for him to push through his remaining agenda. His wish list includes extending current community-reinvestment requirements on banks to the rest of the financial-services industry, a plan Greenspan opposes. The Fed chairman feels that Newman wants to interfere with the free market to achieve a social benefit. And then there's Newman's toughest nut: overcoming congressional resistance to an overhaul of the Glass-Steagall Act to remove barriers between investment and commercial banks and also allow banks to provide full range of financial services.

As Bentsen's deputy, Newman still has to prove that he can master macroeconomic policy, an area in which he has little expertise. Newman will also have to develop his political skills—to be tough on the Fed against excessive interest-rate hikes and referee a split between Administration deficit hawks and doves. Office of Management and Budget Chief Alice M. Rivlin argues that a strong economy allows more debt financing. But Labor Secretary Robert B. Reich contends that as the deficit shrinks, there will be room for more spending.

For now, Newman is straddling the fence. He warns that "we must not let the deficit begin to run away from us" even as he talks about big-government solutions. His strong belief in government incentives to develop communities—the Los Angeles riots help demonstrate that need, he says—probably doesn't qualify him as an enthusiastic deficit-cutter. As the more conservative 104th Congress takes its seat next January, such ideas certainly won't make his life any easier. It could be the winter before Newman begins recalling those mild San Francisco temperatures again.

By E. F. M. and Andrew Ross
with a Washington Post Staff Writer

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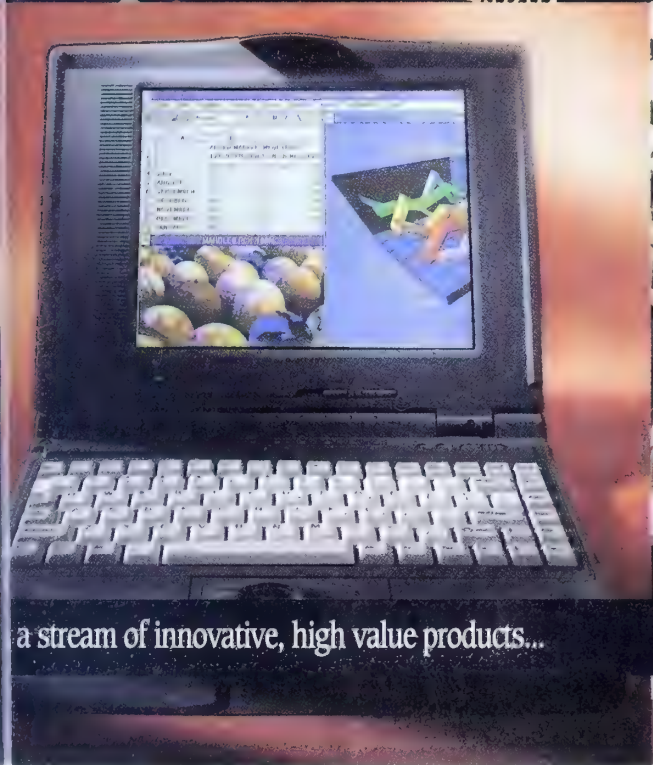


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COMMENTARY

By William C. Symonds

HOCKEY: BE CAREFUL WHAT YOU WISH FOR

With the National Hockey League and its players locked in a stalemate that could eliminate much of the season, you've got to ask yourself: How did this rookie in the land of millionaire jocks and jockheaded millionaires get in such a fix so fast? It took Major League Baseball years of bad feelings and bluster to arrive at the same point.

The short answer is success. Last season, NHL attendance climbed to a record 17.5 million. The league just inked its richest-ever national TV contract with Fox Broadcasting Co., a five-year, \$155 million deal. And new owners Walt Disney, ITT, and Blockbuster Entertainment founder H. Wayne Huizenga have skated onto the ice with fire in their bellies and dollar signs in their eyes. Before the lockout, hockey was being ballyhooed as the hot ticket for the 1990s, with sky's-the-limit prospects for growth and revenues. If the NHL's immediate future didn't look bright enough, the exit of the boys of October presented an opportunity for even greater exposure.

"DIRE STRAITS." But fast ice can be awful slippery. While the explosion of U.S. interest engineered by Commissioner Gary Bettman sent league revenues soaring to last year's record \$717 million, up 80% in just four seasons, the owners used lots of that cash to fuel an even faster climb in player salaries. With the average player earning a cool \$558,000 last season, up from \$232,000 in the 1989-90 season, spending on players has soared 165%, according to league figures. And that has opened a huge chasm between powerhouse franchises such as the New York Rangers and Detroit Red Wings and small-market teams such as Buffalo, Edmonton, Hartford, and Winnipeg. "If we continue on this course, the gap will become even wider," worries Boston Bruins' President Harry Sinden.

And, as the owners' party line goes, that could threaten the future health of the league.

Such talk may seem ludicrous to fans in hockey hotbeds such as New York and Toronto, where an NHL franchise is a virtual license to mint money. Maple Leaf Gardens Ltd., which owns the Toronto Maple Leafs, reported a net profit of \$4.6 million on revenues of \$47 million in the fiscal year ending June 30, even though payroll costs have climbed "\$10 million in four years," says Leafs President Cliff Fletcher. And in their very first season, the Mighty Ducks of

Within a decade, predicts Milwaukee-based sports-valuation expert Michael S. Megna, "there's a high probability" that just three Canadian cities—Montreal, Toronto, and Vancouver—will still have NHL teams. The rest, Megna says, would likely move to bigger U.S. cities such as Denver and Phoenix. But giving up on the small Canadian clubs "would be the worst thing we could do," warns Sinden. His reason: Even though 18 of the NHL's 26 clubs are based in the U.S., two-thirds of the players and most of the coaches are still Canadian.



OILERS VS. DUCKS: A marketing mismatch

Anaheim earned an estimated \$9 million, thanks to the marketing muscle of Walt Disney Co., which helped the Ducks sell more merchandise than any other club.

But as Disney powers toward its goal of making the Ducks "North America's Team," clubs in the NHL's smallest markets "are in dire financial straits," says Massachusetts Institute of Technology Economics Professor Jerry A. Hausman, an adviser to the National Hockey League Players' Assn. The Hartford Whalers, the most troubled U.S. team, lost \$26 million over the past two seasons and was taken over by a state agency before finally being sold for \$47.5 million in June. The problem is even more critical in Canada, where four of that nation's eight NHL franchises play in markets of fewer than 1 million people.

CANADIAN KIDS. Sinden's concern is that if the NHL abandons the small Canadian cities, "the kids in those areas would lose interest, and the NHL will eventually run short of players." But that vision of the sport's future is cloaked in the mistiness of nostalgia and love of the traditional. The hard truth is that with its small-market teams now earning well under half the revenues of such clubs as Detroit, New York, or Toronto, the NHL must make radical economic changes

to keep those clubs going. Two things are needed. First, as the owners suggest, a plan to keep salaries from exploding beyond the growth of league revenues. And second, as the players have proposed, a far more generous system of revenue sharing, so that the small-market clubs will at least have a shot at competing with the big boys.

Far more than the 1994-95 season is at stake. Unless owners and players can agree on such a thoroughgoing and equitable economic restructuring, the NHL will have no choice but to abandon the small clubs. That likely means good-bye to Winnipeg and hello to Hollywood and more owners such as Disney and Huizenga. Success: You can't fight it.

Symonds heads BUSINESS WEEK's Toronto bureau.

Two Strategies for Client/Server Applications Development

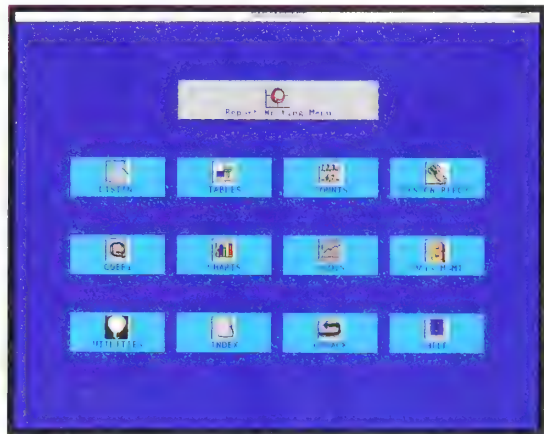
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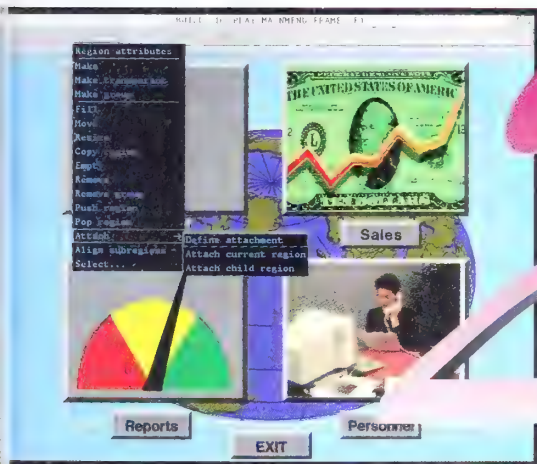
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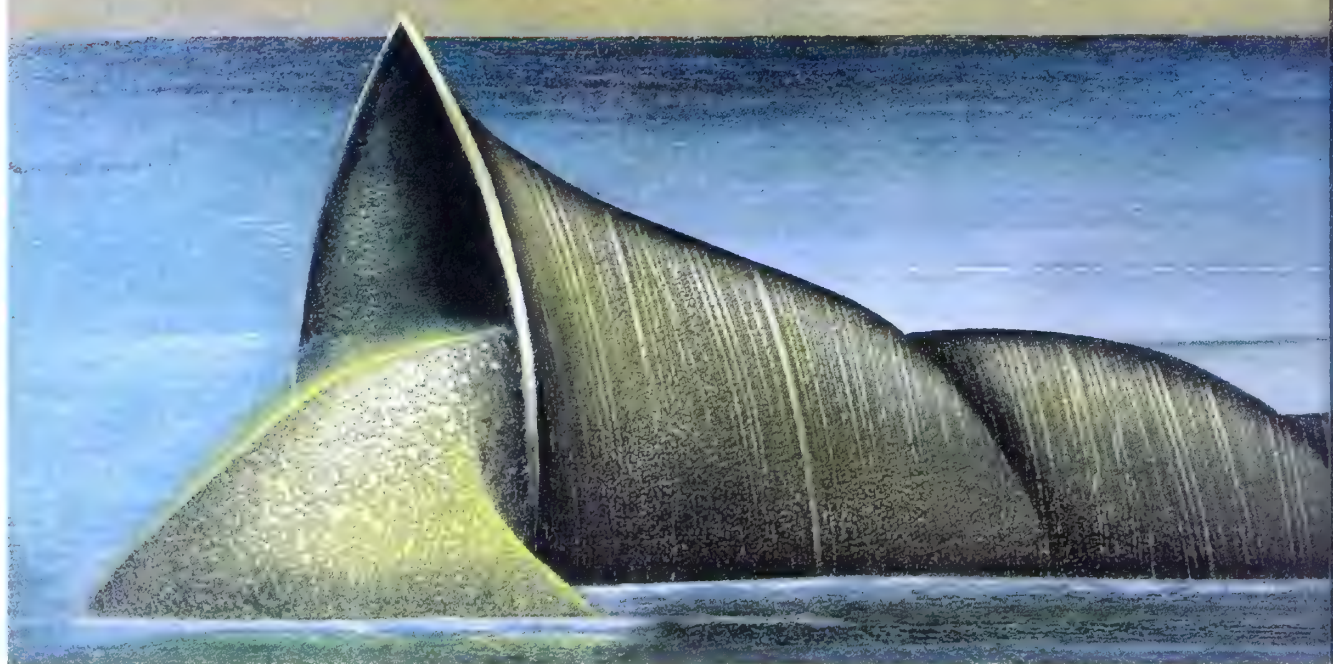
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Special Report



MANAGING

In recent years, the American corporate landscape has been littered with risky financial bets that went awry: Bum real estate loans. Defaulted junk bonds. Rogue brokers at Prudential Securities Inc. and traders at Kidder, Peabody & Co. Troubled mortgage-backed securities portfolios. And most recently, millions of dollars of losses from imprudent investments in derivative exotica by Procter & Gamble, Gibson Greetings, and Piper Jaffray, to name a few.

U.S. companies and financial institutions have typically responded to these crises in helter-skelter fashion, sending in bucket brigades to douse the flames and perhaps install a few safeguards to prevent the same problem from cropping up again.

Now, due largely to the derivatives debacles, many companies, banks, and Wall Street firms are asking themselves whether a knee-jerk approach to managing risk makes sense for the in-

creasingly complex and perilous 1990s. They are beginning to realize that the only way to stem the tide of financial calamities is by fundamentally overhauling the way they deal with risks. They now recognize that the effectiveness of their risk-management program can determine whether they flourish or wither and die.

The most important strategy that is emerging from this evaluation is the development of comprehensive, companywide

programs that target the entire array of a company's risks—not just derivative risks. And those programs go far beyond fancy new hedges from rocket scientist. They get into the very culture of an organization. "The breadth of products offered, the complexity of those products, and the global nature of markets all make top-down, centralized risk management a necessity" in the 1990s, says Thomas B. Whelan, global risk management chief at Morgan Stanley & Co. In that capacity, he sits on ti-

THE OLD WAY

- Fragmented in different departments
- Considered a cost item
- Unwritten, imprecise policies
- Monitoring relegated to auditing and compliance departments
- Narrowly focused finance treasury units
- Finance, treasury a narrow function



RISK

Companies are realizing that only comprehensive strategies directed from the top can end the wave of calamities

is operating committee and oversees the credit committee and internal audit unit.

The creation of high-level risk-manager positions such as Alan's is just one of several managerial initiatives that strategy mandates. "It's a whole new job category, a new function," says Tanya Styblo Beder, a principal at Capital Market Risk Advisors, a risk consulting firm.

Corporate finance and treasury units are transforming themselves from bean counters to active internal financial risk-management consultants that advise companies on every activity from purchasing to marketing. In doing so, they not only help companies out of trouble but boost their competitive position. Internal auditors, once regarded as moles ferreted out waste and fraud, are playing expanded roles as monitors of "soft" items as ethical standards, which, if violated, can increase a company's vulnerability. Risk managers are

also scrutinizing compensation structures to make sure they do not reward behavior that allows employees to boost their short-term results while jeopardizing their firm's long-term reputation.

One of the leading corporate role models for the holistic approach to risk management is surely Merck & Co., the prestigious pharmaceutical manufacturer based in Whitehouse Station, N.J., and its chief financial officer, Judy C. Lewent (page 88).

THE NEW WAY

- Centralized, overseen by senior-level risk manager
- Used to enhance shareholder value
- Formal policies OK'd by top management
- Responsibility of line managers
- Finance, treasury advise business units on risk

Lewent's 500-person unit rides herd over insurable risks, determining, for example, whether to buy insurance against such perils as environmental liabilities or self-insure. And it oversees a wide range of financial risks, particularly foreign exchange exposure. But they are only pieces of what Lewent calls "new" risk management, which, she says, "gets to the heart of the more interesting policy issues."

What really sets Merck apart from

the pack is its effort to assess the risks in the company's business activities. Working on the premise that the aim of risk management should be to enhance shareholder value, Lewent's staff uses sophisticated mathematical models, such as Monte Carlo simulation, to weigh the risks and rewards of all kinds of business

Special Report

initiatives, from acquisitions and joint ventures to research and development expenditures for new drugs.

Several companies are beginning to embrace a risk-control model proposed in a 1992 report by the Committee of Sponsoring Organizations (COSO), a group of leading accounting and auditing associations. The study concluded, among other things, that risk control wasn't just the job of compliance and internal auditing departments, but also line managers, from the CEO on down. Control is effective, the study found, only when managers become convinced that it is part of do-

ing business, not separate from it. Says William C. Jennings, an internal control consulting partner at Coopers & Lybrand, which authored the COSO study: "The guys making the money can't relegate control to someone else. They've got to take responsibility for it themselves."

Unlike traditional risk-control programs, which typically include risk identification and measurement, written policies and procedures, and monitoring, this approach also calls for the CEO and the board to set the moral tone for the company by establishing a control philosophy and disseminating it to employees. "The biggest risk you have is someone screwing up the reputation of the company," says Jennings.

Which is perhaps why troubled Prudential Insurance Co. of America has turned to Coopers & Lybrand to help implement the program companywide to avoid the kinds of financial disasters that have afflicted it in recent years (page 9).

To be sure, only a few derivatives dealers and users have ordered top-to-bottom revamping. Conservative financ-

THE HIGH ART OF HEDGING AT MERCK

For many CFOs, Monte Carlo analysis is still little more than fodder for academic journals. That was the case at Merck & Co. until about eight years ago, when Judy C. Lewent, as head of financial analysis, became fascinated with the notion that maybe these seemingly arcane mathematical models had some value in real life. "I wanted to find a way to facilitate taking prudent risks, as opposed to just being a gatekeeper," she says.

Since then, both Lewent and decision theory have come into their own. As Merck's chief financial officer, the 43-year-old Lewent is now one of America's highest-ranking female executives and a guru for a growing cadre of high-powered female risk managers. And thanks to quantum leaps in computer software, Lewent now uses Monte Carlo analysis—a technique for formulating a set of possible consequences of certain actions—as routinely as she used the slide-rule when she was a graduate student at Massachusetts Institute of Technology in the early 1970s.

Besides using these models to help decide what products to develop, a key application is managing Merck's foreign-exchange risks. Merck has operations in more than 140 countries but pays dividends in dollars and incurs about 70% of its research and development expense in the U.S. So Merck must protect foreign-currency earnings against the vagaries of the dollar to fund dividend and research costs.

Although Merck ultimately decided to use options to hedge this expo-



JUDY LEWENT Chief Financial Officer

"I wanted to... facilitate taking prudent risks, as opposed to just being a gatekeeper"

sure, Lewent says she always explores so-called operational hedges first. For example, even though it might be impractical, a company might reduce foreign exchange risks by moving research and develop-

ment activities overseas—a tough business decision that requires a good deal more analysis than Monte Carlo.

By Phillip L. Zweig
in Whitehouse Station, N. J.

actioners, such as WMX Technologies Inc., based in Oak Brook, Ill., say they haven't changed the way they do things. WMX, says CFO James E. Koenig, runs a conservative hedging program for foreign exchange and fuel purchases. Earlier this year, WMX directors reviewed risk-management operations. No changes were made.

But many companies have implemented some controls and reforms, including rewriting investment policies and control procedures, installing more sophisticated computer programs, and limiting their use of financial instruments to plain-vanilla forwards, options, and futures.

Not surprisingly, some corporate insurers are giving a very cool reception to salesmen from banks such as Bankers Trust, the chief purveyor of highly leveraged derivative instruments that burned the likes of Procter & Gamble Co. and Gibson Greetings Inc. As a result, bankers have become "a little more frank" about disclosing risks, says David P. Roggekamp, manager of capital markets and corporate finance at FMC Corp.

Several companies have renounced the use of their treasury units as profit centers by speculating in the derivatives market, which is what got many companies into trouble. Dell Computer Corp., which lost nearly \$32 million in the first half of the year on derivatives after earning more than \$13 million on derivatives in the previous three years, says it will no longer use derivatives as an investment vehicle. In its annual report for the fiscal year ended June 30, Procter & Gamble, which lost \$102 million after taxes in leveraged swaps transactions, stated that its philosophy is to use financial instruments "to manage risk and cost," but not to speculate. In May, the company announced the formation of what it calls a Risk Management Council, chaired by Vice-President and Comptroller Edwin H. Eaton. To add what Chairman Edwin L. Pratt said was another "level of scrutiny" extending "well beyond normal corporate operating controls." The RMC reports directly to the CEO and board of directors, meets monthly, and consists of senior managers from the various financial and purchasing units.

Other companies are restructuring their management of foreign exchange risk, which has become especially critical as companies have globalized. Until 1992, Rhonda L. Seegal, treasurer at Perkin-Elmer Corp., a Norwalk, Conn., instruments manufacturer, monitored foreign exchange contracts put on by finance officials in each country where the company does business but was not responsible for negotiating them. Early that year, however, with help from Emcor, an Irvington, N. Y., consulting firm, she initiated a pilot project

HOW MERRILL LYNCH KEEPS RISK AT ARM'S LENGTH



Could Kidder, Peabody & Co.'s Joseph Jett fiasco have happened at Merrill Lynch & Co.? Merrill executives insist it couldn't.

The reason: An embarrassing \$377 million trading loss in 1987 caused Merrill Chairman and Chief Executive Daniel Tully to make structural changes that other companies are only now implementing. Tully chose Daniel T. Napoli, a skilled risk taker who was then head of the government securities desk, to occupy the new position of head of risk management. "In retrospect," says Napoli, "it might have been the best money we ever spent. What we learned from that trauma built up the risk culture for the next seven years."

Napoli reports directly to Tully. "I have no profit-and-loss agenda. I protect the chairman, the board, and the shareholders," says Napoli. "As it relates to risk management, no one outranks me except the chairman." Napoli doesn't just passively monitor risk. He also has the ability to tell Merrill's many trading desks to reduce their outstanding positions if

DANIEL NAPOLI

Senior Vice-President

"I protect the chairman, the board, and the shareholders"

necessary. Napoli is careful to exercise this authority only in partnership with the heads of the trading desks, since he depends on good relations with them to keep tabs about potential problems coming in.

Some years ago, a Merrill trader was fired for mismarking positions after Napoli got a tip from a Merrill salesman. "He never thought he was going to get fired, because he was profitable," says Napoli. "No one individual is larger than the firm." That's a lesson other Street firms should not have to learn the hard way.

*By Leah Nathans Spiro
in New York*

to centralize foreign exchange hedging, starting with six countries that represented half of the foreign currency exposure. By offsetting positions in different currencies against each other (such as dollars owed by German units and German marks owed by the parent), the company beefed up control while trimming costs.

The controversy over derivatives risks hasn't deterred some other companies, notably chipmaker Intel Corp., based in Santa Clara, Calif., and Enron Corp., the Houston oil and gas con-

WRITING FMC'S RULE BOOK ON DAMAGE CONTROL

Cheryl A. Francis learned the simple approach to risk management back in the 1980s, when she was chief financial officer at FMC Gold Co., a Nevada mining company. She used the straightforward method of selling through forward contracts to lock in commodity prices. Today, as treasurer of parent FMC Corp., she has made that basic principle—keep it simple—an ironclad rule.

The Chicago-based conglomerate limits itself to plain-vanilla options, forward contracts, as well as futures, avoiding exotic products that have gotten other companies in trouble. "A lot of those benefit the dealers more than the company," says Francis. The practice of writing, or selling, options is out. And counterparty risk is controlled by strict limits on the size of deals with less than AAA credits. Transactions of \$10 million or more require a sign-off from Francis; \$20 million or more need an O. K. from Chairman Robert N. Burt. "[FMC] had excellent procedures already in place, but now they're much more detailed and specific," notes FMC director Clayton K. Yeutter, a former Agriculture Secretary.

Francis also has moved to integrate the risk-management center for FMC, whose 21 far-flung business units deal in 35 currencies. The units identify exposure, then turn to the Chicago office for advice on hedging, cost-effective borrowing, and other financial necessities. In currencies, headquarters offsets FMC's net market exposure with over-the-counter forwards and swaps.

Not all risk management involves derivatives. Francis is working with one FMC unit to finance a new chemical plant in China. She wants to fund



CHERYL FRANCIS

Treasurer

"A lot of [exotic derivatives] benefit the dealers more than the company"

the project in the local currency, but there's no easy way to borrow or hedge it. So she'll borrow from another multinational in China that has renminbi on hand and buy insurance in case China devalues its currency or seizes FMC's assets. Quite a switch from her gold days, but her goal is the same: to minimize risk without getting too exotic.

By Greg Burns in Chicago

cern, from making innovative, and some say daring, use of financial risk-management techniques. They insist that the risks of not using them vastly outweigh the risks of using them.

When Intel Treasurer Arvind Sodhani joined the unit in the early 1980s, he observed that "excess returns" could be achieved by doing

complicated transactions. In managing Intel's \$5 billion cash trove, Sodhani insists that he doesn't make bets on currencies or use leverage. But he has pioneered a number of innovative techniques. One example: using put options to reap windfalls on its stock-buyback program. That has produced gains of \$183 million since Intel began using the idea in 1990 (BW—

Aug. 29). "We look at everything," says. "We don't get scared because the complexity involved. But we examine it to death."

In 1990, Enron arrived at the conclusion that erratic natural-gas prices and the industry's byzantine price regulatory structure was a huge opportunity. Gas producers couldn't count on a stable cash flow from buyers, such as utilities, and utilities couldn't project electric rates accurately because they couldn't anticipate future gas prices.

So Enron set up a kind of in-house merchant bank to serve as an intermediary between the two. Besides marketing gas and financing production, Enron Capital & Trade Resources (formerly Enron Gas Services Group) uses commodity swaps and other complex derivatives to smooth cash flow for both sets of customers. Enron Capital, says CEO Jeffrey K. Skilling, is "essentially taking a very volatile unknown cash-flow stream and converting it to a stable cash-flow stream," adding that Enron's risks are minimized by careful credit analysis and "matching" purchases and sales. "We're never more than 1% out of balance," he says. These activities earned the company \$169 million pretax in 1993.

Like their corporate counterparts, many big banks and Wall Street firms are reinventing risk management by giving it top-level attention. They are now trying to determine how much capital and earnings their individual businesses and institutions have at risk under different scenarios. "You take risk in whatever you do," says Dennis Weatherstone, chairman and CEO, J.P. Morgan & Co. "But if you understand the measure, and account for them, they should keep you out of trouble."

To accomplish that, a number of institutions have lately centralized their risk-management activities and appointed risk managers to head them.

Take J.P. Morgan. Every day, Morgan's risk-management unit compiles a one-page "4:15 report," which gets har-

ded to Morgan's top six executives by that time of day. The report is a snapshot of Morgan's entire foreign exchange, interest-rate, commodity, and equity positions, among other exposures. Using complex correlations and volatility data, it calculates Morgan's "daily earnings at risk"—the maximum amount Morgan has a 5% likelihood of losing per day.

Earlier this month, in a bid to establish its risk-measurement practices as the global standard, Morgan began offering a risk-management program—dubbed RiskMetrics—available free to anyone with a modem and a PC. Users will be able to obtain daily risk data on different instruments and currencies through electronic services and calculate their exposures over one day or one month.

Swiss Bank Corp. has a system that is, at the same time,

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simple and rigorous. According to Robert Gumerlock, managing director, Swiss Bank takes what it calls a "market shock" approach. Gumerlock produces a daily report showing how the bank would fare in the event of a "worst case" event, such as a sharp and protracted rise in interest rates accompanied by a

sustained 10% movement in foreign exchange rates.

In the aftermath of Citicorp's early 1990s brush with disaster, largely because of bad commercial real estate loans, the nation's largest banking company has formalized and expanded its risk analysis and controls. At the core of its problems: No one was watching the buildup of loan concentrations in certain industries—notably commercial real estate—and in geographic regions.

Citibankers now review the bank's credit and market risk exposure in each of what Chairman and CEO John S. Reed calls its "windows on risk." As part of this process, every company in an industry is risk-rated, and individual countries and industries have their own limits or trip wires. Now, there are limits by geography and, in real estate, by the type of real estate.

Citicorp's day-to-day risk-management process places heavy responsibility on line managers, in part because Corp's businesses are so far-flung. The bank believes managers need to be able to control their positions, says Thomas Jones, the bank's top financial officer. Every business unit has a financial officer, but a single person monitors risks in derivatives worldwide, he says. Citicorp Treasurer Peter Clant oversees risk limits for particular businesses and tracks the overall corporate risk limit, Jones says.

Effective risk management, though, extends beyond Monte Carlo simulations, 4:15 reports, and risk-management councils. It also requires a risk-sensitive culture that permeates the entire organization. Morgan Stanley's Whelan says that no centralized unit can take the place of control-minded employees. "Risk management is not a bunch of guys on the 50th floor."

Some companies seem predisposed to repeated problems perhaps because they have weak risk-management cultures. Take Gibson Greetings. In addition to its well-publicized \$19.7 million derivatives loss last March, Gibson disclosed this year that Cleo Inc., its gift-wrap subsidiary, had over-

THE SENTRY AT BANKERS TRUST

Bankers Trust Co. has come under fire for allegedly selling inappropriate derivatives to its customers, but its internal risk-management system has won praise from analysts for years. Charles S. Sanford Jr., chairman and CEO, developed a risk-based method for capital allocation as a capital-markets executive back in the early 1970s. Today, the system is still in use. In fact, says Raphael Soifer, an analyst at Brown Brothers Harriman & Co., "many of their biggest competitors are using risk-management systems that are clones of Bankers Trust's."

Today, the task of overseeing risk management falls to Daniel T. Mudge, a low-key managing director who joined Bankers Trust after Harvard business school and never left. Mudge earned his stripes in trading and risk arbitrage in London and New York, and he became head of global risk management in 1988. Among other things, he oversees the production of a daily risk report that tallies the bank's exposure in every business and market. It is circulated among half a dozen senior executives, including President Eugene B. Shanks Jr., at the end of each day. "The philosophy is, day to day, be relatively decentralized but have strong central guidance on risk mandates," he says.

SYSTEM SAFEGUARDS. Bankers Trust's risk-management and monitoring systems have not been foolproof, however. In 1988, the bank had to revise downward its 1987



DANIEL MUDGE Managing Director

"What I'm trying for is information—what's happening and why"

earnings by \$80 million because it had overvalued some options positions. But the bank then developed the ongoing reports and practices Mudge now oversees, and it has not had major problems with risk management since then.

Mudge almost never tries to change a trading strategy. "I'm not

going to read something on the tape and go in and say, 'Get your Mexican position to zero,' he says. "What I'm trying for is information—what's happening and why." While Mudge does not stop traders from taking risks, he can make sure that any losses that result won't be a nasty surprise.

By Kelley Holland in New York

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stated finished-goods inventory at yearend 1993, forcing Gibson to restate earnings to \$19.8 million, a 23% reduction. In connection with the derivatives fiasco, Gibson has sued Bankers Trust Co. for deception, fraud, misrepresentation, and breach of fiduciary duty. On Oct. 11, Bankers replied, saying in court

Special Report

filings that Gibson knew what it was doing.

After the Cleo disclosures, five shareholder lawsuits were filed against Gibson and its chairman, alleging violations of securities laws. Gibson also disclosed that the Securities & Exchange Commission was conducting an investigation into the transactions. In the most recent development, Gibson in the early part of October fired its accounting firm, Arthur Andersen & Co.

For all the sophisticated analysis and computer models now being deployed to keep America's big companies and fi-

nancial institutions out of trouble, some say that they often save themselves a lot of pain and suffering by using simple common sense. For example, companies typically put managers on the carpet when their results fall below expectations, but most never ask apparent superstars, like Kinder Peabody trader Joseph Jett, to explain results that far exceed normal returns.

Jay Alix, a Southfield, Mich., turnaround consultant, says "Most frauds are not detected by control systems. Most are picked up by chance"—that is, by people who ask smart questions.

Risk managers these days are a long way from having all the answers. But asking the right questions seems like a pretty good way to start getting a good handle on risk.

By Phillip L. Zweig in New York, with Kelley Hollahan and Leah Nathans Spiro in New York, Peter Burrows in Dallas, Greg Burns in Chicago, and Zachary Schiller in Cleveland

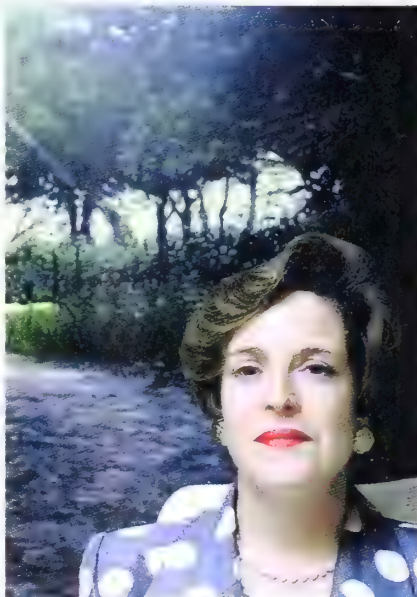
PRUDENTIAL: MAKING IT ROCK-SOLID AGAIN

Few companies are better candidates for a business-school case study on Murphy's Law than the beleaguered Prudential Insurance Co. of America.

When the meter finally stops running, the Pru will probably have shelled out more than \$1.1 billion to settle investor claims from 1980s sales of soured oil and gas limited partnerships by its Prudential Securities Inc. unit. Both the parent and the brokerage have been the targets of numerous lawsuits accusing agents and brokers of improper sales practices.

IN CONTROL. Enter Pru Senior Vice-President Martha Clark Goss, who in July was tapped by Chairman Robert C. Winters for a daunting three-year assignment: Install a top-to-bottom system of integrated internal controls in every unit and, along the way, overhaul the corporate culture. A former Pru treasurer and former president of Prudential Asset Management Co., the 45-year-old Goss reports directly to Winters and now holds the auspicious, if unwieldy, title of enterprise integrated control officer.

Although reluctant to go into details, Goss acknowledges that some controls broke down as Prudential decentralized in the late 1980s. To remedy this, the company is installing a comprehensive, integrated risk-control system with the help of Coopers & Lybrand, the Big Six accounting firm. "What's appealing about the approach is that controls are the responsibility of business-unit heads and line managers, not support structures," Goss says. Over



MARTHA CLARK GOSS
Senior Vice President

**Managers should ask:
"What's the worst that
can happen, and could
I survive it?"**

the next year or so, Goss, with the aid of a small staff, will sweep through the company, working with managers to identify risks and then build controls to address them. All managers, she says, will be called upon to ask themselves: "What's the

worst that can happen, and could I survive it?"

Currently, a number of departments evaluate different risks at the corporate level, and a financial-control council meets every week. The company is now considering whether to establish a permanent, top-level risk unit, among other possibilities.

Goss believes the thrust of the exercise is to make sure that "people know what their jobs are, what's expected of them, and that they're accountable for them." She hopes the program will convince employees that they have not only a right but also a responsibility to ask questions if they are instructed to do something they don't think is right or don't fully understand. "The traditional hierarchical management process in this country doesn't empower people to question their bosses," she says.

Goss admits the program has met resistance. Some managers view it as yet another chore. Others seem to think the company is billing it as a miracle cure for the Pru's ills. Goss denies it's a "magic pill." In any case, the program has the backing of Chairman Winters. Says Goss: "Bob has taken a very strong leadership position on this. He said, 'We will do this, and we will do this across the board.'"

What kind of company does Goss expect Pru to be in another year or so, when all the action plans are to be put in place? "Well-managed and in control," she says. For Prudential, that would be a definite improvement.

By Phillip L. Zweig in New York

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HEDGING COMMANDMENTS

Rules to live by in a dangerous game

As treasurer of the U.S. operations of Swiss pharmaceutical maker Ciba-Geigy Ltd., Walter D. Hosp helps protect a \$5 billion global cash hoard with an array of options, swaps, and other derivatives. But Hosp maintains a healthy respect for these instruments. "Derivatives," he says, "are nothing more than a set of tools. And just as a saw can build your house, it can also cut off your arm if it isn't used properly."

Over the past year, managers and shareholders of corporations from Procter & Gamble Co. to Metallgesellschaft have found out just how true Hosp's assessment is. All have suffered large losses on derivative deals as supposedly ironclad hedging strategies came unglued. But it didn't have to happen that way. Had these and other companies heeded some fundamental principles of hedging, the losses might never have occurred. Hedging works only if it is approached in a comprehensive fashion—something that's too often ignored in the frenzy to adopt ever higher-tech instruments and techniques. With everyone from corporate boards to shareholders and regulators now trying to figure out why derivatives dealt so many players such heavy blows, it's high time managers reviewed some basic rules.

NO SWAPS. First off, you don't have to hedge everything. Mobil Oil Corp. protects itself against swings in interest rates and currencies, but not petroleum prices. It holds that shareholders expect to take on the risk of the oil market when they buy Mobil shares. And Bally Entertainment Corp. CFO Lee S. Hillman isn't hedging any of the casino operator's \$1 billion in long-term debt right now.

After Hillman locked in cheap fixed rates on the debt last year, he decided against swapping some of it into floating rates. With short-term rates far lower than longer ones at the time, such a swap might have saved Bally a bundle. But Hillman decided not to take the risk that short-term yields would climb. When the Federal Reserve hiked rates early in 1994, his judgment was vindicated. "Interest rate hedging is speculative," he says. "We don't like to gamble with our shareholders' money."

Behind Hillman's strategy was a carefully made decision that every manager should consider. Hillman figured that the potential cost of assuming floating-rate debt via a swap would be about the same as leaving his fixed-rate borrowings alone. Doing such a ba-



sic calculation should tell you whether, and how much, to hedge.

Figuring out the cost of hedging isn't enough. Before signing on to any strategy, perform a thorough examination of your company to unearth where its biggest vulnerabilities lie. Are you willing to live with short-term fluctuations in pursuit of a longer-term goal? Do you need to hedge revenues, profits, dividends, or cash flows? And where are your biggest foreign exchange risks?

Companies also need to implement a clear corporate policy on hedging. Even after the recent derivatives blowouts, many boards still haven't produced written guidelines for hedging. That's not smart. A financial manager must know whether or she is supposed to trade for profit, or merely to offset changes in the market value of such items as accounts receivable or outstanding debts. Setting a corporate policy out-

lines the black and white of hedging, eliminates a lot of confusion, and perhaps wards off a corporate trader's temptation to cross over into pure speculation.

At Ciba-Geigy, currency is regarded as "a strategic asset," says Hosp. "It's there to provide liquidity for a company—it has to be there when there's a need for it." As a result, the treasury department is not under pressure to take extreme risks. It can earn large returns on every trade. Other companies, in

WHEN TO HEDGE...AND WHEN NOT TO

KNOW YOUR RISKS Before you start a hedging program, you need to know where your greatest risks are. It may pay to have a consultant give your company a thorough going-over to spotlight vulnerabilities and recommend a hedging strategy—or none at all.

KNOW YOUR TOLERANCE FOR LOSSES Putting on a hedge is similar to buying insurance. Before you buy the policy, you must decide how much you're willing to lose in relation to what the protection will cost.

KEEP IT SIMPLE Exotic derivative instruments can be hard to value unless your treasury has an armory of analytical tools. Without them, you may end up paying too much. And financial exotica may have a hidden potential for losses.

DON'T GET GREEDY The excitement and romance of financial markets has lured many a treasurer into heavy losses. Unless your directors want you to trade for profit, regard your job as one of protecting the company's capital.



ing Intel Corp., trade more aggressively. There's nothing wrong with that. But experts say if you do want to trade for profits, make sure traders have a separate pool of capital—as if they were in a bank—and that they have well-defined limits on how much of it they can risk.

To head off trading surprises, the board must always know what you are trying to achieve and how you are doing it. Every company also needs an independent audit committee that can review risk-management activities and clamp down when things go awry.

Y ROADS. One example of what can happen when responsibilities are unclear is the \$1.6 billion oil-trading loss at Metallgesellschaft, the big German metals conglomerate. Academic circles are buzzing this fall over Nobel prize-winning economist Merton H. Miller's postmortem of the loss, which was run up by MG's U.S. energy unit. Miller contends that MG's strategy to hedge its refineries' oil output fell apart when its main lender, Deutsche Bank, panicked after it saw the mounting cost of rolling over the company's huge oil-futures positions. MG maintains that its former managers had put together a fundamentally flawed hedging strategy that was doomed to fail. But whoever is right, one big question remains: Why was there such confusion about the oversight of the hedging campaign that ran into the billions? With more rigorous and timely internal reporting, the mess might never have developed.

Keeping everyone informed is only part of the game. Picking your strategies is every bit as important. Remember that derivatives aren't the only way to hedge. It can cost you a lot to use derivatives to hedge against changes in the value of currencies in emerging markets—if you can do it at all. Just to buy forward contracts for the Russian ruble, which fell more than 20% of its value in just one day in October. But you still can protect yourself in countries where currencies or interest rates may gyrate wildly.

When one multinational manufacturer saw that its Brazilian assets were swelling, it simply boosted its local borrowings

Emulate the best. Among them: Ford, Merck, Mobil, Coca-Cola, and Lexmark

ing, the system it uses to measure its own vulnerabilities in debt instruments, currencies, equities, and swaps.

Finally, emulate the best in the business. Plenty of corporations hedge responsibly, successfully, and carefully. Financial experts rank Coca-Cola, Colgate-Palmolive, FMC, Ford, Lexmark, McDonald's, Merck, Mobil, 3M, and Union Carbide among the very best. Why? Their boards have clear policies for hedging. Financial managers know trading limits in advance, and know who they must see to obtain approval for big deals. They also have developed sophisticated analytical skills. Says Abraham George, a risk-management expert who runs Multinational Computer Models Inc., in Fairfield, N.J., "They just don't go out, buy instruments, and make money."

With derivative losses still shaking up financial markets, few CFOs are likely to be taking that approach. But many still need to improve even their simplest hedging strategies before they can sleep well at night.

*By William Glasgall in New York,
with Greg Burns in Chicago*

to increase its liabilities. A recent study by the Financial Executives Research Foundation notes that Bechtel Corp., the global engineering group, sometimes arranges to be paid in a basket of currencies that mirrors what it must lay out to cover its costs. And WMX Technologies Inc., a waste-management company based in Oak Brook, Ill., guards against sudden spikes in interest rates by staggering maturities of its debt. "We're not traders," says CFO James E. Koenig. "We're not trying to beat anybody."

Whether you regard yourself as a trader or not, be sure you can calculate the value of every hedge. That will alert you to possible losses and give you the data you need to crash-test your portfolio with worst-case simulations. "You must be in a dialogue with the system every day," advises Rolf-Michael Reinhardt, a foreign-exchange dealer at the German chemical giant BASF.

This is especially important in the case of complex leveraged instruments. Fortunately, you can now buy sophisticated software packages that collect data and make value assessments that are as accurate as those used by banks. For example, Zurich-based Olsen & Associates supplies treasurers with a currency-trading model that uses millions of second-by-second price changes around the world to help identify broad valuation trends. Banks are also improving the quality of information they give to their customers. J.P. Morgan & Co. in October began making available, free for the asking,



HANG ON TO THE SECURITY

“Don’t panic and get out at a low price. Do the restructuring yourself”

— HEINZ BINGGELI

DEFT PLAY WITH DERIVATIVES

Dumping dogs isn’t the only option

Just call them “The Fixers.” Their job: extricating investors from some of Wall Street’s most complex securities. Their clients: the mutual funds, pension funds, and other big investors who bought derivative securities as hedges and bets on falling interest rates and logged huge losses.

With the cumulative damage from derivatives approaching \$9 billion, business is booming for the fixers. At first, as interest rates began rising sharply, sending the value of the securities into a tailspin, panicked investors dumped their holdings. But now they find they have more options. Rather

than coming hat in hand to the firm that created the derivative, investors find

themselves being wooed by rival firms eager for new business. And both Wall Street and the growing ranks of independent risk consultants are showing clients better ways to deal with derivatives.

Even the big investment banks are joining the ranks of the fixers. “We’re saying that we didn’t necessarily sell you that security, but we can help you defuse the risk,” says Peter W. Bennett, a managing director at J. P. Morgan. The resources and client interest in restructuring derivatives at J. P. Morgan is three times greater this year than last year, he says.

Defusing risk doesn’t mean getting rid of a security. “Don’t panic and get out at a low price,” says Heinz Binggeli, managing director of Emcor Risk Management Consulting Corp. in Irvington, N. Y. “Do the restructuring yourself and lock in the loss, unless you think the price will improve.” For exam-

ple, he says, a client could restructure a so-called inverse floater and get a better overall return than if they sold to a dealer.

The rate on inverse floaters moves dramatically in the opposite direction to interest rates. Investors bought these securities by the bushel to capitalize on falling rates. Two years ago, a buyer of a turbocharged 5-year inverse floater got a coupon of 4.75%, plus a sweetener that magnified the yield all the way up to a lip-smacking 25%. But today, with short rates way up, what do the holder have? A note that pays no interest and has a value of 81¢ on the dollar.

Dump it? No, says Binggeli. He suggests reducing the interest rate risk by doing a “reverse transaction” that is the mirror image of the original one. The interest rate risk in the old agreement is offset by the new agreement. And the

holder still gets the 4.75%.

The fixers say their major task is to explain to their clients the pros and cons of holding on to derivatives. “In more than one case, the decision has been to hold on to a portfolio or the risk has been understood,” says James Midanek, of Stone Asset Management, in Walnut Creek, Calif. The risk from the derivatives may be balanced out by rejiggering other parts of the client’s portfolio, possibly reducing interest rate risk or increasing liquidity elsewhere.

ALL BUT THE KITCHEN SINK. Some securities, however, such as “kitchen sink” bonds, which combine the riskiest portions of mortgage-backed bonds, should almost always be sold, says Midanek. “They make analysis very difficult,” he says. “I don’t care how big your computer is, you can’t get your arms around them.”

But the fixers maintain that they can help tip the scales in a seller’s favor. Binggeli cites an example involving a Southern western pension fund. The fund held currency-linked notes but didn’t know how to value the securities and had been selling them back to their dealer for 80¢ on the dollar. Binggeli analyzed the securities and explained how they were being priced in the market. As a more educated consumer, the fund approached a different dealer, explaining why the notes were worth 83¢ on the dollar. After factoring in a profit, the

dealer bid 81.5¢ on the dollar. A penny and a half may not seem like a lot. But on a note with a face value of \$1 million, that meant that the pension fund netted \$750,000 more.

Unwinders say that companies do go too far in ridding themselves of derivatives, especially when the derivatives are used for hedging, not speculating. Says Tanya S. Becker, a principal at Manhattan-based Capital Market Risk Advisors Inc., “We’ve seen situations where a company purged itself of derivatives and the result was even greater risk than it had before.”

By Suzanne Woolley in New York

Special Report

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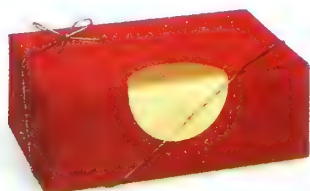


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Special Report

MAJOR MARKET MELTDOWN?

Unlikely. The system is surprisingly secure

The financial blows dealt by rising interest rates last spring hit novices and pros with equal force. Private money managers and major corporations alike suffered devastating losses. Had any of the large institutional players failed, some firms trading with them could have been forced to close down, which could have set off a chain reaction. That reminder of the potential for disaster has raised anew a troubling question: How vulnerable is the global financial system to a major meltdown?

The answer—surprisingly—seems to be not very. Sure, technology, exotic financial instruments, and the growing globalization of markets mean that disturbances can be amplified and more widely felt. But since the 1987 stock market crash, central bankers, regulators, and stock exchanges have imposed new protections, from trading curbs to increased capital requirements. It is also true that the presence of many more players in the capital markets today than there were a decade ago helps to spread the risks. “The chance that a major economic shock would result in the domino failure of major financial institutions has declined,” contends Franklin R. Edwards, a professor at

the Columbia University Graduate School of Business.

More changes are in store. Several widely publicized losses earlier this year from the use of derivatives have goaded officials around the world into a broad examination of the adequacy of the capital “cushions” for these new products. And they are pressing for new disclosure requirements for companies using them. For their part, many companies, seeking to avert similar problems with their treasury operations, are taking steps to tighten their internal controls.

SHOCK ABSORBERS. The 1987 crash was a turning point in managing systemic risk. The Oct. 19 debacle exposed deep flaws in the financial system, ranging from outmoded trading systems to slow settlements of trades. So-called “circuit breakers” installed by the New York Stock Exchange in 1987, which limit program trading in volatile periods, have been credited with reducing the severity of stock market swings. The Big Board has also upped the capital requirements for its specialists. And it now has a hot line to regulators, which allows better communication during market crises. “The 1987

crash was clearly a call to everyone to shore up their systems,” says Susan M. Phillips, governor of the Federal Reserve Board.

Regulators also scrutinized ways to improve global clearing and settlement procedures in the wake of the crash. In 1987, outmoded systems made settling trades a lengthy process in the U.S. and Britain, taking up to 15 days in Britain. Those delays increased the risk that firms would get into trouble during times of market turbulence, for some would still be waiting to be paid for old trades even as they were trying to react to new market price swings.

The collapse of Drexel Burnham Lambert Inc. in 1990 underscored the risks of slow settlement. When Drexel was on its last legs,

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stitutions that had committed to mortgage-backed securities trades with the firm balked at delivering securities they owed Drexel. Their fear was that Drexel would close its doors in the interim and not deliver on its side of the transactions. The ensuing, potentially destructive gridlock in the mortgage-backed securities market ended only when banks made it clear they would lend

Special Report

Drexel enough money to meet its obligations.

In the wake of the Drexel problem, the mortgage market has modernized its practices to speed settlement. And now, thanks to a Securities & Exchange Commission rule adopted in 1993, equity and corporate bond trades in the U.S. will be settled in three days by the middle of 1995, down from the current five. "The market can deal with almost anything as long as people think they'll get paid," says E. Gerald Corrigan, the former president of the Federal Reserve Bank of New York who is now chairman of international advisers at Goldman, Sachs & Co.

Regulators have also been working to strengthen the banking system. In 1988, central bankers established risk-weighted capital requirements that gave banks incentives to stick to low-risk investments and businesses. And since 1990, thanks largely to low interest rates, commercial banks around the globe have built up hefty capital cushions to help them weather losses. The Treasury Dept. says capital levels at U.S. banks are at a 30-year high.

SPEED TRAPS. Glanders remain, of course. Globalization and the speed with which transactions move today mean that problems can spread more quickly, for one thing. The failure of a major Japanese bank could cause losses for lenders ranging from Merrill Lynch & Co. to Deutsche Bank to a small regional bank in France. Adding to the developing risks is the fact that investment houses' ongoing development of new hybrid and derivative securities means that new and potentially destabilizing dynamics are constantly being injected into the market. "A lot of good things have been done," says Corrigan. "But there is no shortage of issues" remaining to be resolved.

One potential problem that has yet to be eradicated is a type of settlement risk dubbed Herstatt risk, named for the failure of a German bank, Bankhaus Herstatt, in 1974. When the bank was closed, time-zone differences left it with huge dollar-mark trades still unsettled. In response, the major-currency payment systems nearly ground to a halt. The big differences in trading hours among firms in the \$1 trillion-a-day market continues to create settlement delays and bottlenecks. An October report by a committee sponsored by the New York Federal Reserve warned that unless this problem is addressed, the risk remains that the collapse of a major player could

cause a chain reaction of failures. Firms could find themselves short millions of dollars if they paid for a trade with a failed firm but did not receive what they were owed. That could severely imperil currency markets.

Commercial bankers and central banks are working to reduce this type of exposure. Beginning in 1997, the Federal Reserve will open its Fedwire payments system eight hours earlier, at 12:30 a.m. And U.S. and European banks are establishing clearinghouses for foreign currency transactions that will reduce the number of trades outstanding at any one time. "By 1997, Herstatt risk will be substantially or completely eliminated," predicts New York Fed President William McDonough.

NOT VERY REVEALING. Limited disclosure rules create another major risk. Today, many investors are basically flying blind when they plunk their money down on mutual funds

that invest in risky financial instruments or in predictable emerging-country markets. That raises the risk that downturns in those markets could send investors scrambling to sell. And when players in derivatives markets cut a deal, it's hard to know how much exposure each has on the other side—and how certain it is they will be paid what they are owed. "The current accounting rules [relating to disclosure] are woefully inadequate," warns former Securities & Exchange Commission Chairman Richard C. Breeden.

Problems with disclosure are now attracting major international attention. U.S. and international accounting groups are working to develop rules that would

require standard and understandable disclosure of risks stemming from major movements in financial markets by every corporation exposed to those shifts. And the SEC is working with mutual-fund companies to develop one-page summaries for mutual-fund prospectuses that lay out clearly a fund's riskiness.

Though a broad breakdown in the system seems less likely now than it once did, few participants in the market are complacent. "No one ever wants to dismiss the small probability that a large problem could occur," says the Fed's Phillips. Though disclosure has increased, there are vast sections of the global financial market that remain largely invisible, which could permit large structural defects to develop undetected. Still, the reforms of the past few years suggest that risk management and disclosure will get continuing attention in the coming months and years. That will never make markets completely safe, but it's a clear step in the right direction.

By Amy Barrett in Washington, with
Phillip L. Zweig in New York

DEALING WITH GLOBAL FINANCIAL RISKS

Progress has been made on many fronts:

CAPITAL Higher bank capital standards take into account credit risk from some derivative instruments

MARKET VOLATILITY Controls put in place after the 1987 crash decrease the likelihood of wild market swings

TRANSACTION CLEARING Improvements in settlement and clearing procedures promise to reduce the number of transactions outstanding across the system

But much remains to be done:

DISCLOSURE Better disclosure is needed on risk posed by emerging market investments, derivatives, and other volatile instruments

CROSS-MARKET RISK Improved global market linkages would reduce risk in foreign exchange transactions

RISK MEASUREMENT More sophisticated measures of risk from major moves in interest rates, currencies, and other markets could aid in setting bank capital levels

DATA: FEDERAL RESERVE, NEW YORK STOCK EXCHANGE, BUSINESS WEEK

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BY GENE G. MARCIAL

PSYCHED UP FOR A HOSPITAL BUYOUT?

Will Weinstein thinks he has found the next batch of takeover bets in health care: operators of hospitals and nursing homes. In this group, he sees Community Psychiatric Centers as the most attractive and cheapest stock, currently trading at 13.

Weinstein, who heads the San Francisco investment firm Genesis Merchant Group, is convinced that big hospital-management companies as well as large HMOs have started positioning themselves to become giant "supermarkets" of the hospital industry.

"Before long, we will see only about five major companies, with each providing all kinds of health-care facilities and services under one roof," says Weinstein, a director of Beverly Enterprises, one of the largest such outfits. The improving economics and fundamentals of the industry, he maintains, have propelled this change. After a depressed period of divestitures, hospitals are on their way to full recovery and expansion, he notes. The flurry of takeovers and consolidation means that giants such as Columbia/HCA Healthcare will continue to ac-

tients stable enough to be released from the hospital but still too ill to go home or to a nursing facility.

After a loss last year, which was caused in part by charges for restructuring, Community Psychiatric Centers is back on track, analysts think. "Solid second-quarter results have reinforced our conviction that the stock has long-term appreciation potential," says Oppenheimer analyst Lori Price. Part of this is due to further improvement in its core psychiatric operations, says Price, who sees earnings of 40¢ a share this year and \$1 in 1995. Even without a takeover, Weinstein believes the stock price will double in the next 12 months.



WILL WEINSTEIN

CHIPMAKERS HAVE TENCOR 'SIZZLING'

For a small company, Tencor Instruments has mighty big customers: Intel, Motorola, and Advanced Micro Devices. And there's nothing small-time about its stock performance. Tencor, which makes testing systems for semiconductor wafers, has rocketed from 9 a year ago to 35 recently. Some investors may be bailing out, but not some major institutional holders who own big chunks and are buying more. What gives?

It's "growth—more to the point, sizzling growth up ahead," explains Arnold Schneidler of A. R. Schneidler in New York. Try this for size: After Tencor earned 43¢ a share in 1992 and 66¢ last year, analysts expect the figure to zoom to \$1.40 this year and \$1.80 next. Revenues are projected to jump from \$120 million this year to \$200 million next year.

"Tencor is one elegant way to play the red-hot semiconductor business," says Schneidler. He thinks Tencor's 1995 earnings will outdo the consensus estimate and hit \$2 a share. So he sees the stock price hitting 50 in a year.

Explains Schneidler: "The more plants Intel and Advanced Micro Devices build to produce semiconductor wafers and chips, the more demand there will be for Tencor's innovative testing systems." They're used to lo-

cate, count, and characterize particles contamination, and other defects on wafers. Its products will be important in making 16- and 64-megabit dynamic random-access memories.

A HEE-HAW PLAY IN VEGAS

In the booming gaming world, Las Vegas Entertainment Network has been a big bust, with its stock hitting 1½¢ on Oct. 17, down from 8 last year. But some pros have scooped up shares lately—to enjoy what "we expect will be a nice ride up, finally, through the next couple of years," says Chris Heltor who heads the equity department at BankAmerica. He thinks plans to renovate the company's 20-acres on the Las Vegas strip will soon get off the ground. The hotel, formerly the El Rancho Hotel & Casino, has 800 guest rooms and a 52-lane bowling alley.

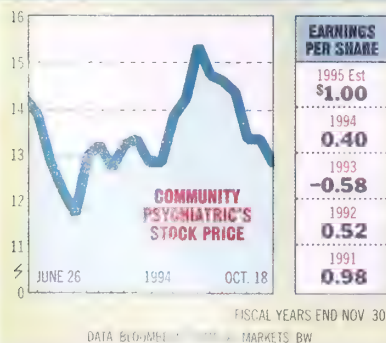
Part of the problem stemmed from delays in putting up a new building—t to be shaped like two 40-story cowboy boots and named Countryland USA Hotel & Casino. The holdup was caused by lack of financing. But now, a Dallas investment bank has committed \$3 million for construction, followed by further \$150 million.

But that isn't all that's prompting bullishness on the stock. One big company that owns a casino and several gambling riverboats in Branson, Mo, has met with Las Vegas Entertainment to talk about buying a big stake in the company. This operator wants to manage and control Countryland USA.

Las Vegas Entertainment also plans to launch Las Vegas Country Television Network, which would feature country-western entertainment and other shows on the Las Vegas strip, says Joseph Corazzi, chairman and CEO.

Another boost for shareholders: Las Vegas Entertainment plans to form two divisions—one the Countryland hotel casino and the other the Las Vegas Communications unit, which would operate the TV network. Then, there would be a special dividend, consisting of one share of the casino-hotel and three-quarters of a share of the television network. "It's a case where the pieces of the company are worth more than what the stock is currently selling for," says James Walker III, a senior vice-president at the investment firm of Auerbach, Pollak, & Richardson in Stamford, Conn.

ON THE ROAD TO RECOVERY



quire hospital chains, and HMOs will do the same in their group.

Before they're finished, he says, these groups will gobble up outfits such as Community Psychiatric, which operates 47 centers—with about 4,000 beds—in California and other states, plus Britain and Puerto Rico. The centers provide drug therapy, alcohol rehabilitation, and occupational and recreational therapy. The company also owns 12 transitional-care hospitals—for pa-



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TRADITION BE DAMNED

Matsushita's radical restructuring has it well on the way to a turnaround

In the past year, MCA Inc. has become a much-admired trophy at Matsushita Electric Industrial Co. And for good reason. Matsushita acquired the film, television, and record company in 1990. But while MCA's Universal Pictures has recently spun out such movie hits as *Jurassic Park* and *The Flintstones*, with equally impressive profits, the rest of Matsushita's sprawling empire hasn't fared nearly as well. A plodding, bureaucratic management, combined with a prolonged recession in Japan, translated into high costs, weak sales—and ultimately three years of falling profits.

Now the Osaka-based giant is being challenged by a restive MCA management, which wants to take greater control of the entertainment jewel (page 112). The tumult couldn't have come at a more frustrating time for Matsushita's new boss, President Yoichi Morishita, who has been laboring mightily to bring the rest of the company up to MCA's glittering standards. Twenty months into his tenure, Morishita has propelled the world's largest consumer-electronics company into the most aggressive management overhaul in its history.

TOUGH TARGETS. The changes at Matsushita, long derided as an also-ran to innovative Sony Corp., have come to define the *risutora*, or restructuring, under way throughout Corporate Japan as it struggles with the aftermath of the painful recession and the current downturn in exports caused by a soaring yen. Instead of depending on a centralized bureaucracy, Morishita is slashing his headquarters staff. He plans to transfer 6,000 corporate administrators to hands-on marketing, sales, and production jobs.



NOTHING SACRED: Morishita is slashing bureaucracy and decentralizing decision-making

The 58-year-old CEO has even challenged the sanctity of lifetime employment: He has begun offering five-year contracts to scientists to work on special research and development projects. "One of our biggest challenges in approaching the 21st century is improving white-collar productivity," says Morishita.

Most unusually for Japan—where executives generally shy away from explicit performance targets by which they can be judged—Morishita has enunciated his goal quite clearly. By 1996, he wants to widen profit margins from 1.5% to 5%. He seems to be making progress: Matsushita's pretax profits rose 12% in

the fiscal first quarter ended in June \$376 million, while sales rose by 3% to \$16.4 billion. That's a profit margin of 2.3%. Analyst Joseph Osha of Bear Stearns Securities (Japan) Ltd. figures that Matsushita's profits could climb 32% a year—to \$1.9 billion—even though revenue is expected to remain unchanged at \$66 billion (chart). The company's margins could climb to 2.9% as a result.

That would represent quite a turnaround for Matsushita. In recent years the company depended heavily on televisions, VCRs, and stereos sold under its own brand names as Panasonic, Technics,

sar. Together with the appliances, these margin goods accounted for 41% of Matsushita's sales, the rest of its revenue coming from electronic components, when appliances, and industrial machinery (see page 110). But other Asian nations are making the products—and so more cheap—Matsushita's sales slipped. Still, its costs remained high. As at other Japanese companies, Matsushita's sales profit growth had been so automatic in the 1980s that runaway expansion of unproductive headquarters staff went unnoticed.

Morishita's predecessor, Teruo Tani, took responsibility for the company's sagging sales and resigned abruptly in February. Officially, Tani was leaving to take a sabbatical for a spate of profile embarrassments at Matsushita. In one incident, the company had to recall or replace 700,000 defective refrigerators. The cost: \$300 million and a loss of its corporate prestige. But most company insiders believe he was forced out by Chairman Masaharu Matsushita, son of the company's late founder, Konosuke Matsushita. Tani's sudden departure sent shockwaves through the company's corporate world, where CEOs are almost unheard of. It seemed especially unthinkable at Matsushita, long a bastion of conservative management.

The next surprise came when Chairman Matsushita tapped Morishita to lead the company. The most junior of Matsushita's executive vice-presidents, Morishita was never considered a true contender for the top spot by Matsushita's shareholders. Age wasn't his only handicap. Since joining the company in 1957, Morishita had worked almost exclusively in sales, including supervising the Corporate Industry Sales Div. Matsushita had always been headed by an engineer. Still, his selection sent a strong signal that the company wanted a clean break with its past. That view was reinforced when the company failed to elect ex-CEO Tani to its board, as is customary in Japan. "It's obvious [Morishita] has a clear-cut mandate for

Matsushita Retools Management

Sets clear performance goals to motivate its executives, such as boosting its profit margin to 5% by 1996 from 1.5%.

Reduces management layers to cut costs and improve efficiency. A plan to transfer 6,000 administrators to sales, marketing, and production jobs by 1996 will further reduce bureaucracy.

Decentralizes decision-making so that division chiefs have responsibility for everything from product development to financing. All managers must submit their own personal three-year plans for reviving their departments or divisions.

Overhauls R&D by consolidating and focusing efforts. By signing scientists to five-year contracts, it's drawing top talent while challenging Japan's notion of lifetime employment. Researchers also receive bonuses based on the success of their work, not the company's performance.

an entire layer of management at headquarters that traditionally oversaw the company's 44 divisions. All were reassigned. Meanwhile, the heads of Matsushita's various operating divisions were given full responsibility for product development as well as production and finance. In effect, each division "owns" its factories and sales offices and has its own balance sheet. Matsushita itself acts as the "shareholder" of each division.

This restructuring has transformed division chiefs into entrepreneurs. If they believe they need financing, say, to build a new factory, they can borrow the money from their parent. Matsushita's current annual interest rate stands at 6%. That's slightly above the prevailing market rate of 5%, but Matsushita demands less collateral and allows its units

change," says Chuck Goto, a managing director at Smith Barney Shearson Inc. in New York who follows Japan's electronics industry.

Morishita hasn't wasted much time fulfilling that mandate. Within 10 months of taking charge, the modest and affable CEO, who prefers long, solitary walks to playing golf with his peers, announced an audacious three-year plan to get Matsushita back on track. He called his strategy "Four-S Management"—for simple, small, speedy, and strategic. "I wanted to simplify management," he says. "I hate taking a long time to study things. I want to condense things, American style."

Decentralizing Matsushita's management was the key to his plan. For starters, Morishita eliminated

easier repayment terms. And as Matsushita grapples with *endaka*, or the surging yen, division heads can decide independently whether to move manufacturing operations overseas or shift to cheaper suppliers offshore. Such devolution of power and focus on individual responsibility are rare in Japan, where group-oriented decision-making has been the norm and micromanagement from above common. "Our past presidents used to worry about everything from tiny lightbulbs to import systems," says Mikio Higashi, a managing director and the head of Matsushita's information equipment division.

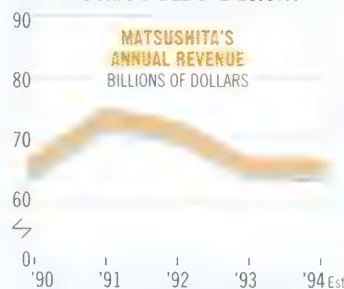
MANAGEMENT PRIMER. In the same spirit, Morishita has required every manager from the lowest up to give him a personal "revival plan" for his own department or division for the next three years. "This is the first time in years that I've felt such direct pressure from one of our presidents," confides one veteran manager. And to make sure that his executives, who number in the thousands, stay focused on improving management, Morishita has also issued each of them a tiny blue booklet, called *Essential Management*, setting forth his principles. Matsushita won't reveal the contents of the booklet, but the company says it deals with issues of greater autonomy for executives. No Matsushita manager would be caught dead without a copy in his vest pocket for frequent reference.

Morishita is taking a decidedly different tack with the company's research and development operations, opting for

centralization to help transform new technologies into products more quickly. Matsushita has often been slow when it comes to introducing new products. For example, it didn't start marketing its version of the more powerful lithium ion rechargeable battery, a popular consumer product, until 1993—a full two years after Sony had introduced its battery.

To avoid similar delays, Morishita has consolidated Matsushita's massive \$4 billion R&D program, pulling disparate engineering sectors into a Corporate Research Div. to handle basic scientific research. A similar Product Development Div. uses that research

Sales Are Flat...



...But Profits May Rise



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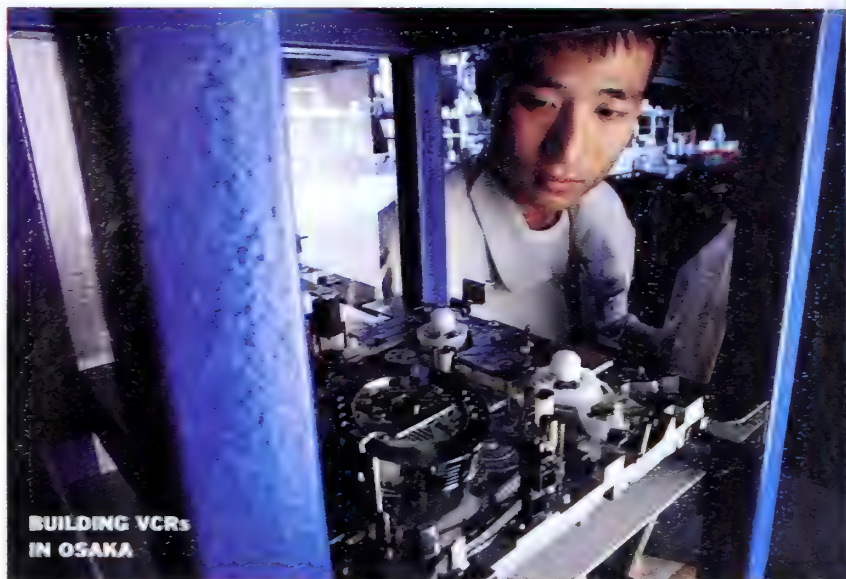
The Corporation

to develop new products. He also created and chairs an R&D council of representatives from dozens of Matsushita's affiliates, such as Victor Co. of Japan Ltd., that meets monthly. "One of our biggest challenges is in reducing the time it takes to get R&D results to our operating divisions," Morishita says.

HEADACHES APLENTY. While Morishita has certainly reshaped Matsushita's management, he still faces some daunting challenges. Guiding his company down the Information Superhighway may be his biggest. Former CEO Tanii had dished out \$6.1 billion for MCA, hoping to push Matsushita into the entertainment "software" that would presumably play a synergistic role with his company's hardware. But MCA isn't Morishita's only media headache right now. In January, 1993, Matsushita announced that it took an undisclosed stake in 3DO Co., a Silicon Valley startup that has developed an electronic box to give multimedia capabilities to ordinary television sets. The box, called "Real" in Japan, for realistic, uses CD-ROMs to run computer games and other interactive programs. It's considered crucial to Matsushita's entry into the potentially lucrative multimedia software business.

Making the units under license from 3DO and developing games and other software for it, Matsushita hoped to sell 1 million Reals in Japan during the first year. But since the machine's debut in March, only about 200,000 have been sold despite price-cutting. At that rate, Matsushita is having trouble attracting top software houses to design games and other programs for Real. Meanwhile, marketing of a game based on *Jurassic Park* and developed by MCA has been delayed for months. Matsushita says it wants to make the game "more interesting." It's now due out in December.

Also brutally disappointing have been sales of Digital Compact Cassette machines, a much-promoted technology developed with the Netherlands' Philips Electronics that allows the playing and recording of traditional analog tapes or new digital ones on the same portable player. DCC competes directly against Sony's Mini-Disc, a recordable portable CD player—and so far, the Mini-Disc has fared much better on the mar-



BUILDING VCRs
IN OSAKA

Matsushita wants to lower its reliance on low-margin consumer electronics, so it's centralizing R&D in an effort to speed it up

ket. "This is difficult," Morishita admits. "We don't have any plans to drop it immediately, but it is hard to see how customers will eventually respond."

Elsewhere, Matsushita is playing catch-up in liquid-crystal displays, one of the most competitive and profitable products sold by Japan's electronics industry. Among the world's top 20 manufacturers of LCDs, Matsushita claims to rank about eighth. Sharp Corp. has staked its claim to the No. 1 spot. But Matsushita isn't sitting still. During the next two years, Managing Director Higashi says, the

company expects to spend \$250 million to boost LCD production capacity.

But Matsushita's biggest strategic play in recent years was the purchase of MCA. And Hollywood, it seemed, was the one place where Matsushita could trounce archrival Sony. Last year, MCA produced \$300 million in operating profits on revenues of \$4.1 billion, and some estimates place the unit's current value at \$9 billion to \$10 billion.

Sony Pictures Entertainment, by contrast, has been a big drag on its parent. Unlike Matsushita, it has gained notoriety for turning out so many big box-office flops, most infamous: Arnold Schwarzenegger's *Action Hero*. "We t-

we did good shopping," said Matsushita Executive Vice-President Tsuzo Murakami before the studio began agitating to take back control.

At an Oct. 18 meeting, Morishita rejected MCA managers' demand for more control of the company. But the showdown with MCA Chairman Lew R. Wasserman and President Sidney J. Sheinberg means Matsushita's biggest foray into entertainment software may be derailed. "If they don't move more into software, I don't know where their growth is going to come from," says Peter Wolcott, senior analyst at CS First Boston (Japan) Ltd. in Tokyo.

For now, sales of Matsushita's televisions, air-conditioners, and refrigerators are booming worldwide. But the kind of prosaic businesses aren't the kind of commodities Matsushita can stake its future on. And even if the Japanese giant stabilizes MCA, the entertainment company can't cure all of its problems. Morishita has to make his company more innovative and less risk-averse. With the rigid corporate culture so endemic in Japan, the challenge is how to take every ounce of salesmanship. Morishita has learned over the years. Still, it's the only way Matsushita can ever hope to make new additions to its corporate trophy case.

By Robert Neff in Osaka

Matsushita at a Glance

Communication & industrial equipment

Video equipment

Home appliances

Electronic components

Entertainment

Auto equipment

Batteries and kitchen products

Other

SHAPE OF
1994
REVENUE

DATA: COMPANY REPORTS

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MCA: A RIFT RUNS THROUGH IT

It was billed as Hollywood's equivalent of Yalta or Bretton Woods: a meeting among potentates that could dramatically shift the power balance in the entertainment industry. But when the top executives of MCA and its parent, Matsushita Electric Industrial Co., ended their talks at San Francisco's Mark Hopkins Hotel late on Oct. 18, it was clear that the Japanese giant wasn't giving an inch. The standoff—pitting MCA Chairman Lew R. Wasserman and President Sidney J. Sheinberg against Matsushita's President Yoiichi Morishita—has entered a new and even more bitter phase.

Wasserman and Sheinberg want their Japanese bosses to grant them more autonomy in running the studio, which they sold to Matsushita for \$6.1 billion in 1990 (page 108). Executives close to the two say they asked Matsushita to give them both more financial support and control. Matsushita refused. Now, the 81-year-old Wasserman is threatening to resign at the end of 1995 from the company he has run for four decades. Sheinberg, 59, hasn't disclosed his plans, but people close to him say he may leave, too.

Given Wasserman's long ties to MCA and his legendary status in the industry, some Hollywood insiders think his threat is merely a ploy to force concessions from Matsushita. Nevertheless, as Matsushita weighs its options, the question it must ask is: Can its entertainment empire thrive without this tough-minded duo at the helm?

UPS AND DOWNS. Certainly, Wasserman and Sheinberg have experienced both triumph and tribulation under Matsushita's ownership. MCA's Universal unit has been on a hot streak recently with *Jurassic Park* and *The Flintstones*. Before that, though, it suffered a three-year drought with such high-priced duds as *Far and Away* and *Havana*. MCA Records Inc. has broken few new acts lately, while theme-park attendance in Orlando has been dampened by

recession and fears of crime. After annual revenues increased from \$3.4 billion to \$4.1 billion since the acquisition, MCA's revenues for the first fiscal quarter of this year have decreased by 2%, to \$1.28 billion, says Yoshihide Kondo, an analyst at Daiwa Institute of Research in Tokyo.

More important than the numbers,



SHEINBERG AND WASSERMAN: POWER PLAY

Matsushita's muted culture is being rocked by the noisy struggle for control of its \$4.1 billion film, record, and theme-park subsidiary

perhaps, are the rock-solid relationships that Wasserman and Sheinberg have cultivated with Hollywood's creative elite. A framed poster of *E.T.* hangs in Sheinberg's office, signed by "your brother Steven" Spielberg. Sheinberg gave the superstar director his first assignment behind the camera. And if he and Wasserman left, so would Spielberg. That would probably kill a *Jurassic Park* sequel that Spielberg is planning. Other heavyweights, such as Ivan Reitman and Ron Howard, might exit as well.

Spielberg is important for another reason. The director recently an-

nounced he was teaming up with music mogul David Geffen and former Walt Disney Co. studio chief Jeffrey Katzenberg to launch a new film studio. Conspiracy theorists believe the "dream team" venture could serve as a vehicle to acquire MCA. People close to the three confirm that if Matsushita were to put MCA up for

sale, they would consider a bid. Wasserman and Sheinberg are contemplating a buyback of the studio themselves, but they didn't broach the issue at the Oct. 18 meeting.

HALFHEARTED. Whether Matsushita sells or stands firm, its go-slow strategy toward MCA is coming under scrutiny. Insiders say the company has thwarted several Wasserman and Sheinberg initiatives to

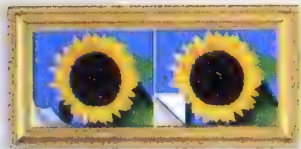
build the studio, including a 1992 bid to buy Britain's Virgin Records. Matsushita has also been slow in approving a \$1.5 billion Universal Studios theme park in Osaka. And executives close to MCA say it blames Matsushita's Panasonic unit for a halfhearted launch of the 3DO Co. interactive game system. MCA and Matsushita are both investors in the software company.

Wasserman and Sheinberg believe MCA must join in the current flurry of media dealmaking or else risk being left behind. The company has recently explored deals with two regional telephone companies, a joint bid for TV network NBC Inc. with ITT Corp., and an alliance with cable titan John C. Malone. Without Matsushita's support, though, "Lew and Sid saw themselves sitting on the sidelines," says one Hollywood power broker. Now, MCA's duo may be sidelined for real. That would make the future of MCA—and of Matsushita's investment—murkier than ever.

By Ronald Grover in Los Angeles with Mark Landler in New York and Robert Neff in Tokyo



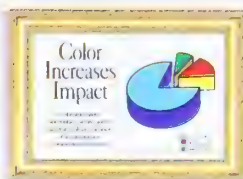
KATZENBERG, SPIELBERG, GEFFEN: "DREAM TEAM"



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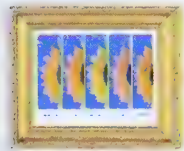
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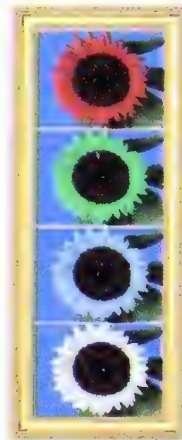
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AMERICAN AIRLINES MAY BE TOO HEALTHY

With profits back, labor is balking at more sacrifices

In the high-stakes poker game known as the airline industry, American Airlines Inc. holds a better hand than most. The Fort Worth-based carrier enjoys healthy cash flow, a strong brand name, a powerful route network, and a young jet fleet. And after racking up \$1.3 billion in red ink over the last four years, parent company AMR Corp. posted record third-quarter profits of \$205 million before preferred dividends, while its first-half operating margin of 7% beat most major rivals.

So why isn't CEO Robert L. Crandall happy? Although two years of tough restructuring have improved finances, Crandall must now tackle American's sky-high labor costs—and if he fails, the efforts to revitalize American may come to naught. "In this game, the worst thing in the world is having a strong hand," says an industry veteran.

That's because American's relative success is hindering Crandall's efforts to slash costs an additional \$1 billion a year, \$750 million of which would come from workers. Pressure from low-cost carriers is leading all major airlines to ask employees for cost relief. But unlike Northwest Airlines Inc., which won \$886 million in wage concessions last year, or USAir Inc., now in talks with its unions, American doesn't face a crisis. And unlike United's unions, the Allied Pilots Assn., representing 9,900 American pilots, isn't interested so far in trading productivity concessions for equity. "There is no near- or midterm financial distress in this corporation," says APA President James G. Sovich.

Credit for that goes largely to Crandall's extensive efforts to slim the carrier. Since 1992, more than 8,000 jobs have been cut. Crandall yanked American out of unprofitable peripheral markets and closed its San Jose (Calif.) hub, while strengthening core routes such as Dallas-Chicago. He also dropped costly jet ser-

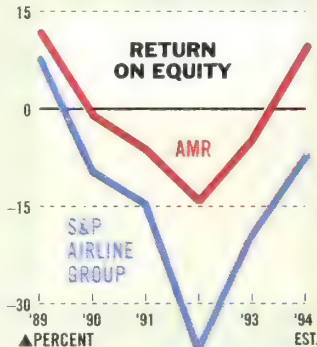
vice to 30 small cities, replacing most with cheaper turboprops. That has cut American's fleet by 49 planes from its 1993 peak. "American is embarking on the right strategy: abandoning ubiquity and focusing on their strategic assets," says an executive at a rival carrier. **PEEVED PILOTS.** But despite the cuts, American's fundamental problem remains: Its costs are too high in an industry where low-cost, low-fare carriers increasingly set prices. The likes of Southwest, ValuJet, and Continental Airlines now compete on 40% of American's nonstop domestic routes vs. only 8.5% early last year. Since Southwest

AMERICAN'S TURNAROUND... ..SHOWS RESULTS

EMPLOYMENT Has slashed 8,200 jobs since late 1992. Now restructuring airport and reservations agent workforce to save \$130 million a year.

FLEET SIZE By yearend, will have cut 49 planes, bringing jet fleet down from 1993 peak of 691. Dismantled San Jose hub and withdrew jet service from 30 cities.

SERVICE To woo higher-paying customers, now offers three classes of service on key transcontinental routes and built new arrival lounges in London and Stockholm.



DATA: STANDARD AND POOR'S COMPUSTAT, CS FIRST BOSTON

Airlines Co. entered the Baltimore-Chicago route last year, American has cut one-way business fares from \$335 to as low as \$89. "If we don't make ourselves competitive on costs, every shred of evidence in this industry says we will go the way of Pan Am," says Gerard J. Arpey, senior vice-president for planning.

Certainly American's strengths, such as a powerful frequent-flier program and broad international route system, help fend off low-cost rivals. They attract more high-paying business travelers, who produce more revenue per seat. "They don't need much on the cost side to get a big earnings swing," says analyst Michael W. Derchin of NatWest Securities Corp. If labor concessions are not forthcoming, he anticipates profits of \$467 million for 1995, up 40%, on revenue of \$16.8 billion.

Yet even if it achieves \$1 billion savings, American's unit costs will be nearly 65% above Southwest's, and adjusting for flight length. So even leaner American won't battle Southwest head-on with limited-service, short-haul flights, as United is doing in California with its Shuttle. Instead, American will stick to longer, full-service flights. But claims that cutting costs, together with higher revenues, will enable it to hold ground. "You don't run away as quickly," says Robert W. Baker, executive vice president for operations. "You stay and offer more seats at [Southwest] prices."

Still, absent immediate financial distress, American's pleas for help from pilots are falling on deaf ears—and APA's decisions will influence contract talks next year with the Transport Workers Union. They may also color arbitration hearings with flight attendants who struck last fall. American was \$300 million in cost cuts from the pilots. But they denounce American's proposal as an attempt to gut work rules. Although APA head Sovich says the union will negotiate productivity gains, he rejects the demand for \$300 million savings. "We're not going to set a fixed dollar goal," says Sovich.

That leaves Crandall with only one lever to press on the pilots: the threat to shrink the airline even further and concentrate investment in more lucrative airline units such as SABRE Group, which includes the reservations system. Although SABRE provides only 9% of AMR's total revenues, NatWest Securities estimates it will earn about 10% of pretax operating income of \$562 million this year. Already, American's fleet will decline by 11 more planes next year, and, without cooperation from labor, the number will fall further. Says Michael Lowry, president of Aviation Forecasts & Economics: "Crandall has no incentive to invest in American Airlines."

One AMR board member warns that the pilots are misreading Crandall; they believe the threats to downsize are only a negotiating ploy. "They're dead wrong," he says. He insists American will continue to shrink unless a drop—and the unions will have to realize that's no bluff. The question is how soon, and how much smaller American will be by the time that happens.

By Wendy Zellner in Dallas



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APPLE'S MAN IN JAPAN STEPS UP THE MAC ATTACK

Frank Sanda is an insider and a born dealmaker—just the right mix to battle Windows

ay you've got a Japanese subsidiary with a bigger market share than your parent company has at home in the U.S. Yet, while your worldwide market share has stalled at below 10%, in Japan you're gaining several points a year and sales are booming. What do you do?

If you're Apple Computer, you ease out the head of the subsidiary, along with a dozen other top executives. Sure, the group had done a tremendous marketing job, but headquarters—under new chief Executive Officer Michael A. Spindler—had something more ambitious in mind. The person in charge of the Japan subsidiary would play a critical role in the company's future—continuing the push into the world's second-largest computer market and forging alliances with computer makers that could flood the globe with Macintosh clones.

Meet Frank Sanda, the new head of Apple Computer Japan Inc. In July, the 40-year-old executive took over the office atop Apple Japan's headquarters overlooking Tokyo's National Stadium. He brings a helpful mix of marketing experience to the \$1.1 billion Japanese subsidiary—everything from ads to cellular phones. Even better, he brings a special knack for dealmaking—Japanese-style.

RESPECT. All these skills will be needed. For despite Apple's rapid growth—analysts figure it could grab 10% of the Japanese market this year, up from its 1992 share—the Macintosh faces big challenges. The most important is Microsoft Corp.'s Windows operating system. Already, sales of PCs running the DOS/V operating system—a Japanese variant of Microsoft MS-DOS—are growing even faster than the Mac's.



GRAB A PARTNER: Sanda seeks an alliance with a Japanese PC maker

DOS/V, sold by IBM, Compaq Computer Corp., and other top PC makers, is displacing older standards such as NEC Corp.'s proprietary "98" format and is expected to grab 28% of the market this year. DOS/V machines, as well as NEC PCs, can run Windows. Microsoft figures 70% to 80% of PCs shipped in Japan now have Windows.

Skillful marketing and a strong partnership with its local distributor, Canon Sales Co., helped Apple build a powerful brand image in Japan. But Apple also got lucky: It took until mid-1993 for Microsoft to bring out a solid, standard Japanese-language version of Windows. That gave Apple Japan more time to build a Mac

following. Says Ian W. Diery, general manager of Apple's Personal Computer Div.: "We are much better respected than Windows or Microsoft in Japan."

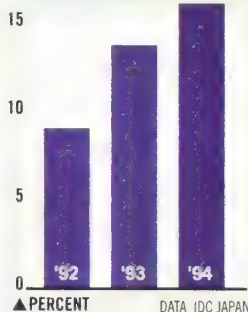
Sanda's plan now? Primarily, he will seek new markets. Apple's best market in Japan is in selling Macs to offices. Now it's aiming at the traditional U.S. strongholds—education and home computing. Operationally, he'll stick with the "leveraged model" that has worked so well. Apple builds no Macs in Japan and sells through distributors, allowing the billion-dollar subsidiary to run smoothly with just 250 employees. Such efficiencies and Apple Japan's 35% revenue growth helped contribute to the company's surprisingly strong 1994 earnings—net income jumped from \$87 million to \$310 million as sales rose from \$8 billion to \$9.1 billion for the year ended Sept. 30.

Sanda's most important assignment will be to nail down a major Japanese computer maker to license the Mac technology. Such a partner would boost Mac's share in Japan and export clones to other markets. NEC, whose proprietary architecture still has 47% of the Japanese market, isn't interested. And Fujitsu Ltd. recently broke off licensing talks because it felt that Windows had closed the gap with Macintosh.

At the moment, Toshiba Corp. appears to be the leading candidate. Apple's cause got a boost on Sept. 29 when Toshiba licensed the PowerPC chip architecture, developed by IBM in partnership with Apple and Motorola

WHERE APPLE REALLY SHINES

SHARE OF JAPAN'S PERSONAL-COMPUTER MARKET



TELECOMMUNICATIONS

Inc. Toshiba now could license Apple's technology to run on a PowerPC chip. Sanda won't say with whom he's negotiating, but he does acknowledge that the Toshiba-IBM deal helps. "This makes Toshiba a potential supplier of Apple products," he says.

You might say Sanda was born to make deals. His father married a scion of a prominent family in the giant trading conglomerate Mitsui & Co. and became a key executive in its North American group. "Trading companies in Japan are the wheeler-dealers. That's in the blood," says Sanda.

RAILWAY MAN. Sanda's family moved to Chicago when he was eight years old. He went from "Seiji" to "Frank" and, after earning engineering degrees at the University of Detroit, moved on to Harvard business school. His first job was with Canadian National Railways. Prior to joining Nippon Motorola Ltd. in 1990 to help run its cellular-phone business, Sanda also worked for Merrill Lynch & Co. At Motorola, his bicultural upbringing allowed Sanda to play a key role as fixer in sticky negotiations between Motorola and Japan's Posts & Telecommunications Ministry when the cellular-phone market flared up as a trade issue in 1990 and 1991.

At times, Sanda found himself fighting Motorola headquarters to get them to play by Japanese rules. For example, when a key Motorola technology for coding and decoding voice signals was incorporated in the new Japanese digital-cellular standard, Motorola wanted to charge a fee to users. But Sanda insisted the technology be given away, to win points with Japanese regulators and industry players. "If you want to change things here, you have to do so as an insider," says Sanda.

Sanda's finesse will come in handy as Apple Japan plots its strategy for making inroads on Japan's Information Superhighway. He is interested in seeing Apple build systems to deliver interactive TV, video-on-demand, and other consumer services. Sanda is also tracking the evolution of wireless communications in Japan, in hopes of finding markets for Apple products such as the Newton.

Apple's continuing success in Japan may be key to the beleaguered company's worldwide revival. Says Sanda: "Maybe we'll see that being here in prominence will allow us to move into other markets." After all, if you can pass muster in Japan's demanding market, you can cut it anywhere.

By Larry Holyoke in Tokyo, with bureau reports

FROM ISRAELI MISSILES TO CELLULAR PHONES

Geotek's military technology could help in the wireless wars

The glass-shrouded diamond at the top of Philadelphia's 60-story Liberty Place is ringed inside with radio and television antennae. Way up in the corners, you will find four small boxes attached to the glass. Those unassuming receivers represent the first steps to convert technology developed for missile guidance into a commercial communications system. The company that owns them, Geotek Communications Inc., figures it has the cheapest method yet for giving business customers the anytime-anywhere communications they need. And it has \$50 million from investor George Soros that says this is a better wireless mousetrap.

The key? Geotek has the exclusive worldwide license for a technology called Frequency Hopping Multiple Access (FHMA), which crams more into a given slice of radio-wave spectrum than is possible with conventional cellular. The Rafael Armaments Development Authority, the Israeli military's research and development arm, developed FHMA to keep radio transmissions to missiles secure. The technique addresses one of the big problems facing any wireless network: how to prevent calls from interfering with one another. With conventional analog cellular systems, where calls are transmitted as a continuous wave,

avoid an overlap and in one cell cannot be transmitted over a frequency that is in use at the same time in neighboring cells.

LUCRATIVE NICHE. FHMA programs the signal for voice or data call into packets of digital bits—to "hop" from one frequency to the next. The packets move in a predetermined sequence calculated to ensure that a call is never on the same frequency at the same time as one in a neighboring sector.

cell. By making use of the many channels between packets, Geotek says it can increase capacity by 27 times over today's analog cellular setups.

That might make FHMA a hot contender to cellular. But that's not in Geotek's business plan. Geotek's Geotek system will not have the wide range of a national cellular service. It is designed strictly for sending voice and data to and forth to trucks or cars operating within a given region. Portable handset sets will not even be available at first, only in-vehicle phones. But the technology could prove lucrative. Bear Stearns & Co. analyst David A. Freedman estimates that Geotek will have 700,000 subscribers by 2000, generating



"You may have a heavy price to offer for wireless national coverage, and to the market niche we are serving that's just not important."

YARON EITAN, Geotek

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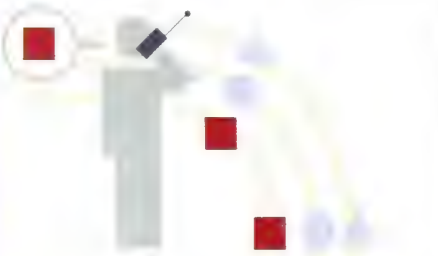
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Information Processing

nual revenues of about \$414 million.

Geotek's goals are in stark contrast to the bold plans of Nextel Communications Inc. Both companies use the Specialty Mobile Radio (SMR) channels once reserved for radio dispatchers. But Nextel wants to build a national wireless network over SMR bandwidths—at a cost of \$2.5 billion—to compete with cellular. Its first regional system in Los Angeles required 126 antenna sites and cost \$200 million. Geotek figures it will need fewer than 60 sites between Boston and Norfolk, Va., at a build-out



CONVENTIONAL CELLULAR

With conventional cellular, a call stays on a single frequency.



FREQUENCY HOPPING CELLULAR

With FHMA (frequency hopping multiple access), each transmission within a cell "hops" from one frequency to another according to a predetermined pattern. This technique can increase calling capacity by a factor of 27.

DATA: LEITCH COMMUNICATIONS INC.

cost of approximately \$150 million.

None of which has been lost on Wall Street. The company, founded by Yaron Eitan, an Israeli-born entrepreneur, set up shop in Montvale, N.J., in 1989 and went public in September, 1993. Two months later, Soros bought a 10% stake for \$40 million and Vanguard Cellular Systems Inc., a nationwide cellular phone operator, invested \$30 million for 2.5 million shares, with options to acquire an additional 10 million shares for \$167 million over the next four years.

The stock has bounced from a high of 17 to a low of 6 and now trades around 10. This September, Soros bought another \$10 million worth of preferred shares.

FLEET PHONES. In a market full of high-tech hype, Geotek's modest goals are a welcome relief. "They don't envision Geotek phone in every American home. That's what makes them so interesting," says Mark J. Lowenstein, an analyst with the Yankee Group. Instead, Eitan wants to sign up small and medium-size businesses that manage a fleet of vehicles or a mobile workforce within one region. For those customers, Geotek offers point-to-multipoint, or dispatch communications, plus voice calls, which cellular can't do. "Users have different needs and different budgets," says Eitan. "You pay a very heavy price to offer seamless national coverage, but the market niche we are serving is that's just not important."

The strategy may be risky: Lehman Brothers Inc. analyst Kenneth M. Iwamoto warns that customers could well decide that they would rather have the national roaming associated with cellular or Nextel, despite the higher cost. And Eitan still has to be profitable commercially. For Geotek has yet to turn a profit. In 1993, its losses widened to \$50.4 million from \$2.4 million, while revenues rose to \$47.4 million from \$3 million.

But if the technology works as promised, Geotek could be in the big time in three or four years, analysts predict. The first customers are expected to sign on in Philadelphia in mid-1994, and by the end of that year the company plans to have Northeast coverage. By the end of 1995, systems in 35 cities across the U.S.

where Geotek already has licenses should be in operation, covering a population of 83 million.

The Philadelphia test, which started in September, has produced no glitches so far. But Bear Stearns's Freedman warns that one working cell does not make a system: "They need to show it can work with multiple sectors," he gives Geotek a 70% to 80% chance of success. Not a bad way to turn missile technology into ploughshares.

By Catherine Arnst in Philadelphia

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BIOTECHNOLOGY

AMGEN COULD USE A LITTLE GROWTH FACTOR

Can it keep profits up while awaiting the next breakthrough?

A couple of times a day, on his way to the men's room, Gordon M. Binder checks a bulletin board for the latest word on his company's stock price. Recently, the news has been good for Amgen Inc. shareholders. But the rising share price may also be a warning of what Amgen's 59-year-old chairman and chief executive officer fears most: a takeover bid for the world's largest and most successful biotechnology company. "We're not interested," says Binder. "We think our independence is critical to the Amgen culture."

Binder has good cause for concern. Wall Street, enamored of Amgen's current products but worried that its next hit drug is years away, has been betting that a big pharmaceuticals manufacturer would come calling. This summer's hostile bid for American Cyanamid Co. by American Home Products Corp. reignited rumors that a drug giant with complementary cancer products, such as Bristol-Myers Squibb Co. or Glaxo Holdings PLC, would make a run at Amgen. (Neither will comment.) That has helped drive its share price up to 53%, from a low of 23 earlier this year.

COST CONTROLS. Now, Binder faces a daunting challenge: He needs to keep investors happy—without much hope of delivering major new products for at least three years. To do that, the former chief financial officer of Amgen is implementing cost controls and share buybacks. Those, in combination with new uses for Amgen's current blockbuster drugs, Epogen and Neupogen, should help the Thousand Oaks, Calif. company rack up double-digit earnings growth for the next few years, Binder figures. And that should keep the stock



BINDER'S BIND: Depending on momentum of old standbys

price high enough to stave off any hostile suitors. Just as important, analysts are now optimistic that Amgen's investments in research and development may pay off by decade's end: In June, the company discovered a promising new drug called MGDF. "There are sparks coming out of R&D," says Jeffrey Cadin, biotech analyst at Merrill Lynch & Co. "I think Amgen is back on track."

Back on track? It's hard to imagine that biotech's premier moneymaker ever veered. After all, sales blasted off from zero when Amgen launched its first product, Epogen, in 1989, to hit \$1 billion three years later. And today, while

for funds—or productless and flailing with bankruptcy—Amgen has \$700 million in cash and two blockbuster drugs plus royalty payments. Analysts expect it to earn \$425 million in 1994 on \$1 billion in revenues.

BACK BURNER. Amgen did falter, though. In 1990, George B. Rathmann, the businessman-scientist who had handily led the company during its first decade, resigned as chairman to found another biotech company, ICOS Corp. Six

months later, Binder ousted Amgen's president. The loss of two popular executives caused morale to plummet. And with everyone focused on getting the two products to market, work on future drugs was transferred to the back burner, while some projects simply fizzled. A handful of wound-healing agents, for instance, which Amgen promoted in the late 1980s, never panned out.

Initially, it was easy to overlook a near-empty pipeline, given the potential of Amgen's best-sellers—genetically engineered analogs of naturally occurring proteins. Epogen, the company's brand of erythropoietin, induces the bone marrow to produce more blood cells. Used to combat anemia in kidney-dialysis

patients, many of whom required weekly blood transfusions to accomplish the same thing, it will rack up \$700 million in sales this year. In 1991, Amgen rolled out an even bigger hit. G-CSF, or granulocyte colony stimulating factor—the company calls Neupogen—stimulates the production of certain infection-fighting white blood cells, called neutrophils, to replace those killed off by chemotherapy. Because of effort by many insurers to shave cancer treatment costs, Neupogen is used by fewer than a quarter of the patients it could treat. Still, it will garner more than \$100 million in revenues this year.

Binder is depending on these stars to carry Amgen until it has new products. For the company, he insists, it's not to amass double-digit growth for three years or so, but to be tweaking them for new uses. Epogen sales will grow 10% this year, for instance, because the number of new dialysis patients grows no

BOOSTER Amgen is using financial techniques to lift earnings per share—such as buying back its own stock to the tune of \$300 million per year

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10% a year—and because the Food & Drug Administration approved higher doses this year. Royalties, which pass directly to Amgen's bottom line, are growing, too, as Johnson & Johnson and the drugmaking unit of Japan's Kirin Brewery Co. sell the drug for nondialysis purposes, such as treating anemia in AIDS patients.

As for Neupogen, Binder contends that it will be as good as any new product once Amgen wins an O.K. from the FDA to market it for new uses, such as fighting infections in AIDS and pneumonia patients. AIDS sufferers already account for 20% of sales. But FDA approval, expected by 1997, would spur purchases by clearing up reimbursement issues for patients whose insurers now won't approve the drug's use. And a dozen clinical trials are aimed at proving that Neupogen can fight off infections caused by ever higher doses of chemotherapy.

BLOOD FACTOR. Just in case these spin-offs aren't enough, Amgen is making use of financial techniques to burnish its earnings. For starters, it's bolstering per-share income by buying back \$300 million of its own stock a year. And it's paring costs: For example, it's renegotiating contracts with suppliers in an effort to boost operating margins, now around 42%. This year, it will even open a plant in Puerto Rico to reduce its federal tax liabilities. "It's an interesting management problem when you can't rely on new-product launches to grow the company," says Lehman Brothers Inc. analyst Teena Lerner. "But with the resources they have, Amgen can bridge the gap."

For a while, anyway. Long term, Amgen's prosperity hinges on coming up with new products. Today, its pipeline consists of five entries that, in a best-case scenario, might win approval by the end of the decade (table). The most promising of these, the June discovery, may have a market potential of more than \$500 million. Called MGDF, for megakaryocyte growth and development factor, it stimulates the production of blood platelets and can be used to restore blood clotting to chemotherapy patients.

In June, four companies—Amgen, Kirin, Genentech, and Zymogenetics—announced that they had independently discovered MGDF, also called platelet growth factor or thrombopoietin, and applied for patents. Amgen and Kirin immediately teamed up to develop and market the product, as they did with Epo-

There are many wild cards. New uses for drugs don't always translate into new sales

gen and Neupogen. "In a single morning, we had a deal," says Kevin W. Sharer, Amgen's new president. The arrangement is a good one: The team will be wielding two patents as weapons in the legal battles over patent rights that will almost surely ensue. And most experts give Amgen the edge in bringing MGDF to market, because it can exploit its Neupogen experience and contacts to move the drug through testing and into hospitals.

Meanwhile, Amgen is expanding its research base. It now spends \$300 million a year on R&D, nearly 20% of revenues. Last year, the company hired a team of preeminent scientists to lead a new program aimed at producing drugs

to combat inflammatory diseases such as asthma, diabetes, and arthritis. It also expanded neurobiology research, include so-called neuropeptide antagonists that could fight multiple sclerosis, obesity, and Parkinson's disease. So though, the only such drugs that Amgen is testing in patients are those it has developed with Regeneron Pharmaceuticals Inc., a Tarrytown (N. Y.) startup in which Amgen has invested \$1 million.

In fact, Amgen is stepping up with outside partners: Such spending accounts for more than 25% of R&D. This year, it inked a \$3 million deal with the Massachusetts Institute of Technology to obtain patent and technology rights in the results of certain biological research. It has added to its equity investment portfolio biotech startups, including San Diego's Alanex Corp. and Arris Pharmaceutical Corp. And recently, Binder hired a new CFO from McKinsey & Co. to structure more such deals and to acquire late-stage products—those already being tested in patients.

PATENT PUNCH-UP. Binder's strategy, and its risks, of course, FDA approval of new uses of Epogen and Neupogen don't always translate into a sales surge, as Neupogen showed recently: Purchases barely budged after it was approved for spurring white blood cell production following bone marrow transplants—because many doctors were already using it for that. Moreover, a patent fight cast a shadow over Epogen. In June, the Genetics Institute was awarded a patent on its version of Epogen, and the companies traded lawsuits. The dispute may take five years to solve, and if Amgen loses it will forfeit GI royalties.

In addition, none of the drugs in Amgen's visible pipeline is a potential blockbuster, and the odds are long that all five will move ahead without a hitch. Even if they do, the outcomes may be disappointing. In June, for instance, a drug aimed at the \$3 billion market in treatment for hepatitis C, already has a dozen competitors.

Despite the uncertainties, Amgen appears to have eased Wall Street concerns over its pipeline. But it may be a long time before Binder can stop worrying about a takeover. That's his catch-22: If Amgen does come up with more promising new drugs, they may become an even more tempting takeover target.

By Larry Armstrong in Thousand Oaks, Calif.

Amgen's Potential

The company is doing human trials on nine new indications for its two existing drugs, Epogen and Neupogen. It is also testing at least five new products, for which it expects FDA approval by the end of the decade:

INFERGEN	This new interferon would treat patients with hepatitis C. It would compete with alpha interferon for a \$3 billion market.
SCF	A blood growth factor, used to stimulate blood cell growth for cell transplants during chemotherapy. Likely market: \$150 million.
BDNF	A brain-derived nerve factor to treat Lou Gehrig's disease. In early-stage testing in people.
MGDF	A blood growth factor that enhances clotting during chemotherapy. Potential market: \$500 million.
NT-3	A nerve growth factor, soon to begin testing in people, which will treat nonbrain nerve disorders, such as numbness in extremities caused by cancer chemotherapy.

DATA: COMPANY REPORTS, BUSINESS WEEK ESTIMATES

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*Total shareholder return as of June 30, 1994. Total return requires price appreciation plus reinvested dividends.

EDITED BY PETER COY

ANT STRIDES TOWARD SMALLER ELECTRIC MOTORS

AMERICAN SUPERCONDUCTOR Corp. is making progress toward electromagnetic wire for small, superefficient electric motors. On Oct. 13, the company, based in Westborough, Mass., said it had made a coil of superconducting wire that, when electricity, produced a magnetic field of 2.16 tesla. That figure exceeds the threshold of 2 tesla that is necessary for the use of motor American superconductor hopes to develop with its partner, Reliance Electric Co.

ASC's powerful coil doesn't have to be bathed in liquid helium, which is costly and inconvenient. Instead, it was cooled to a relatively warm 40 degrees Kelvin (-410F) by a tiny, built-in refrigerator and a cryo-cooler. The coil's strong field should allow motors to be made one-half to one-third the size of ordinary motors. Eventually, ASC and Reliance hope to build 10-horsepower superconducting motors for heavy industrial use. Says David Jarbaletier, director of the University of Wisconsin's Applied Superconductivity Center: "This is a technology that is not anywhere near being out."

A CAREFUL CAMERA RADIATION CAN'T FRY

THINK OF THEM AS ENVIRONMENTAL HORROR FLICKS. Westinghouse Hanford Co. is using high-resolution video cameras to monitor highly radioactive materials at the Energy Dept.'s Hanford site in southern Washington State. The image below is from a video of corroded metallic-uranium fuel rods in Hanford's K East storage basin, which is leak-prone and only 1,000 feet from the bank of the Columbia River. While Energy tries to decide what to do with it, the irradiated fuel is releasing uranium, plutonium, cesium, strontium, and tritium into the basin water.

Elsewhere at Hanford, radiation is so strong it can fry remotely controlled cameras in a week. Engineers rigged up periscopes so the camera wouldn't look straight down into the waste. Now, the camera faces sideways and is heavily clad on its underside. Light from the waste is bent by a quartz prism into the camera lens. But radiation isn't bent by the prism, so little of it gets to the lens. Because it's quartz rather than glass, the prism isn't browned by radiation. Engineers hope the cameras will survive about two years. The cameras show whether gas is being released in a slow fizz rather than in violent "burps."



HIGH RISK: Corroding fuel rods threaten the Columbia



KILLING BACTERIA WITH A SILVER BULLET

JUST AS SILVER-PLATED ARMOR shielded wealthy knights of old, silver can be used to protect the body from harmful bacteria. One example is placing drops of silver nitrate in a baby's eyes at birth to prevent the mother-to-child spread of gonorrhea, which can result in blindness.

Implemed Inc., a four-year-old company in Brookline, Mass., is using silver to develop an antibacterial shield for use in hospitals and doctors' offices. It's a silver-polymer material to be used in everything from catheters to wound dressings.

The protective polymer composite is laced with small amounts of silver and platinum. When a fluid touches the coating—be it saline solution, blood, drugs, or urine—silver ions flow out, leaving the platinum behind. The result is a minute electrical current that keeps sending silver ions to combat bacteria. The precious metals add about 50¢ to the manufacturing cost of the catheter, which runs to \$3 to \$5, according to the company.

Exactly why silver stops bacteria in its tracks is unknown. Test-tube results show a 90% reduction in bacterial colonization, an effect that lasts up to 30 days. Animal studies of the catheter began in October. By late 1995, Implemed hopes to market catheters and license the polymer technology to other companies for other applications, such as pins to attach ligament to bone.

AN INTERNET ANGEL PUTS PATENTS ON LINE

THE U.S. PATENT ARCHIVES are one of the richest troves of technological knowledge in the world. To search them, people generally visit one of 78 repositories around the country or pay hefty fees to a commercial on-line service. Now, though, patent data are starting to appear free on the Internet. Gregory M. Aharonian, publisher of the Internet Patent News Ser-

vice in Belmont, Mass., says he took on the project partly as a good turn and partly to drum up interest in other data that he sells. Available so far are titles of patents issued from 1970 through 1993. If funding comes through, next will come abstracts and later the full text of patent claims.

The University of North Carolina is temporarily allowing Aharonian to use its

computers and Internet link. He's trying to raise \$100,000 in donations for a direct line to the Internet, a pair of file server computers, and about 12 gigabytes of disk storage. He plans to buy the patent data from the Patent & Trademark Office or get copies from friends. For those who want to take a look at the new service, it is available through the Internet at <http://sunsite.unc.edu/patents/intropat.html>.

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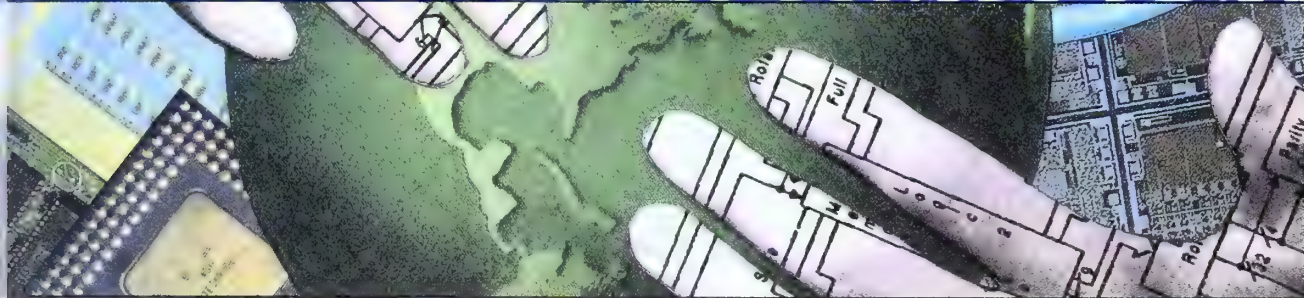


Illustration by Victoria Kann. As seen in BusinessWeek, May 23, 1994 Issue

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EDITED BY AMY DUNKIN

ALL-IN-ONE ACCOUNTS LOOK EVEN MORE APPETIZING

A year ago, it hardly mattered whether you kept your cash in a bank account, a money-market fund, or under your mattress. But with interest rates on the rise, the income you can earn on money you keep in reserve for emergencies or to invest later is becoming something you should pay attention to again. Asset-management accounts, which combine checking, a credit or debit card, and brokerage services, have become the most efficient way to manage cash holdings. And they offer a host of other features that makes it easier to keep track of your spending, saving, and investing.

Merrill Lynch pioneered these all-in-one accounts, also known as central asset accounts, in 1977. Today, most brokerages, and an increasing number of banks, insurers, and mutual-fund companies, offer their own versions. The core elements have not changed much over the years, but many of the fees have come down, and useful new services have been added.

PERSONAL STYLE. BUSINESS WEEK found no serious shortcomings with any of the accounts we examined. With all of them, as long as you can meet the minimum balance, often around \$10,000, you can review your complete financial picture at a glance on one statement. Beyond that, which one you choose is largely a matter of personal style. Do you want a brokerage account with some banking services or a bank account with bro-



FINANCES Any available cash is swept automatically into a money-market fund

kerage services? Do you prefer a full-service broker or a discount one? Discounters offer streamlined asset-management accounts for free, while brokerages and banks charge around \$100 a year to

get some extra services and advice from investment advisers.

With all of the accounts, any available cash from dividends, maturing certificates of deposit, or the sale of se-

curities is swept automatically into a money-market fund, preventing any of interest between transactions. Plus, you receive a line of credit—typically a margin credit secure against your investments—a better rate than most loans.

FEAST OF FUNDS. These accounts became popular in the early 1980s, when money-market funds yielding 10% and rates on bank savings were capped at 10%. Today, the spread between bank accounts and money-market funds isn't quite so dramatic, but it still is significant. The average bank is yielding 2.55% on money-market accounts, according to *Bank Rate Monitor*, while IBC/Donoghue reports the average money-market fund is yielding 4.1%. Plus, asset-management accounts usually offer a range of money-market funds to choose from, so people in high tax brackets can choose a tax-free fund, or cautious investors can stick with Treasury-only funds. "Not only are the rates of return better than they used to be, but also the cost of managing your money inefficiently is higher. So the efficiencies of the cash management account become of greater importance," says John Galvin, Merrill Lynch's vice-president of CMA marketing.

Another argument for asset-management accounts: Effective June 1, securities transactions will have to settle in three business days. No longer will you be able to play the trade, wait for the confirmation statement from your

to arrive by mail, and send in the check. "The [check] is going to be less convenient for most retail investors if they don't have a monomarket account or a virtual asset account," says David Grabish, vice-president at A.G. Edwards. Although you can also hold cash through a brokerage firm in a monomarket fund, you may be limited to writing checks for \$100 or more. Central asset accounts come with no such limitations.

They also come with a variety of tools you can choose to suit your financial goals. Most accounts offer an expense-analysis feature. You can add a code on each check, indicating that it went to medical expenses, insurance premiums, or child care, for example, and your statement will track how much you are spending in these areas. Payment features, which include a touch-tone phone or a personal computer, often are also included.

WARNING. Most people need the extra bells and whistles, though. "We charged \$10 a year for the package [including check-coding and bill payment], but a customer who had significant assets and many transactions to feel that was worth it," says David Morris, a senior vice-president at Fidelity Investments. Three years ago, Fidelity eliminated the fee on the Virtual Service Account and streamlined it to include a consolidated statement, debit card, and check-writing. It also had a tenfold increase in the number of new accounts that month. Customers can still pay a fee a year for an enhanced account, which comes with a debit card with a 30-day delay, expense coding, and a \$5 a month extra-automatic bill payment. Some accounts also allow you to segregate their holdings to meet different investment goals. "What we found in clients' needs were more complex than a single account could handle," says Gallo, who keeps separate ac-

counts for retirement, his children's college expenses, and his and his wife's investments. Merrill charges an extra \$25 for each subaccount opened.

Technological advances have given customers numerous ways to access their accounts. Trading now is available through touch-tone and screen phones and PCs. (Both Charles Schwab and Fidelity offer a 10% discount for people who trade on line.) Citibank began offering trading via automatic-teller machines in October. The next frontier, says Mark Thompson, senior vice-president at Schwab, is the advent of the "personal

find themselves faced with margin calls. "There can be some danger if you put everything in one bucket and then have trouble keeping your goals apart," says William Gregor, senior vice-president at Gemini Consulting in Morristown, N.J.

If you think an asset-management account fits your needs, your first decision is where to turn. The fees charged at banks and full-service brokerages are only worth the money if you need investment advice and have complicated finances. "The negative is that you start getting pushed into company

you get a credit or a debit card? Will cancelled checks be returned to you? Merrill will return 15 checks free a year and provide them all at no charge if you should happen to get audited, even though the Internal Revenue Service will accept its statements. Is there a 24-hour 800-number service? What is the minimum balance required? You need \$10,000 to open a Citigold account but, six months later, if you don't have at least \$100,000 (or \$250,000 if you include your mortgage), a \$25 monthly fee will be charged.

Watch the fees and charges carefully. Compare commis-

Scanning the Asset Management Accounts

ACCOUNT	FEATURES*	MINIMUM FEES/YEAR
A.G. EDWARDS' TOTAL ASSET ACCOUNT ULTRA ASSET ACCOUNT	Members get preferred loan rates. The Ultra account (\$20,000 minimum/\$100 a year) does monthly cost-basis analysis showing purchase prices and current values.	\$10,000 \$60
CITICORP'S CITIGOLD ACCOUNT	Customers can make trades through touch-tone and screen phones, personal computers, and as of October, ATMs.	\$10,000 \$125
FIDELITY'S ULTRA SERVICE ACCOUNT	The enhanced account costs \$60 a year and includes bill payment (\$5 a month), check-coding to keep track of expenditures, and a debit card with a 30-day float period.	\$10,000 FREE
MERRILL LYNCH'S CASH-MANAGEMENT ACCOUNT	Cash Management Account pioneer allows clients to segregate holdings for different goals (retirement, education).	\$20,000 \$100
CHARLES SCHWAB'S ONE ACCOUNT	Offers Street Smart software for \$59, allowing investors to trade mutual funds and stocks on line for a 10% discount.	\$5,000 FREE

*Many accounts share similar features.

DATA: BUSINESS WEEK, COMPANIES

agent." This means that through various means of technology, such as handheld computers, customers will be alerted when a stock is falling, or a portfolio will be reallocated automatically, "making the broker obsolete," he says.

The biggest danger of asset-management accounts is also one of their main draws: easy access to credit. Profligate spenders, using their debit card, can zoom right through their cash holdings and into their credit line without even realizing it. People could spend their emergency funds, or—even worse—if their stocks take a tumble,

products, which are almost always inferior," says David Klaskin, president of Oak Ridge Investments, a Chicago money-management firm. Do-it-yourselfers will appreciate the free account, discounted trades, and wide array of investment choices offered by the likes of Schwab and Fidelity.

FEE SAMPLE. Each account has a lengthy set of rules and features to review. How many money funds can you choose from? Merrill has 14, including several state-specific funds that are double tax-free. Does the account offer daily or weekly sweeps of all cash into money funds? Do

sions on trades at different firms. Are there fees for using ATMs? What is the interest rate on loans? It usually hovers just above the broker call rate (the rate banks charge brokers for money) and is better than you could get from a bank. A.G. Edwards offers its Total and Ultra Asset Account-holders a preferred rate, currently 7.5%, vs. 8.75% for its other clients.

Make sure you're not paying for features you won't use. After all, the purpose of asset-management accounts is to manage your money more effectively. It shouldn't cost you more than you gain to do so. *Amey Stone*

RAILROAD STOCKS MAY BE BOUND FOR GLORY

It's merger mania time in the railroad business, so naturally you'd expect stock prices to soar. Since June, Illinois Central and Kansas City Southern have agreed to merge. So have Burlington Northern and Santa Fe Pacific. And now a war has erupted for Santa Fe, with Union Pacific making a hostile bid and waging a proxy battle.

So what has happened to stock prices? In almost every case, they've dropped. That's creating an opportunity, experts say. "If you have the

patience of an individual investor, there almost isn't a railroad I wouldn't buy," says Anthony Hatch, railroad analyst with PaineWebber.

ACTIVE ARBS. Arbitrageurs and portfolio managers are showing little patience right now. The mergers require approval by the Interstate Commerce Commission (ICC), and that could take as long as two years. Because shareholders won't be seeing a payoff anytime soon, arbs are selling the stocks short, creating downward price pressure, says Michael Lloyd, an analyst with NatWest Securities.

Since late June, when Burlington Northern offered \$13 a share for Santa Fe, BN's stock has dropped 6%, to about \$51. Santa Fe's shares dipped below \$11 in August, but since Oct. 5, when Union Pacific offered \$18 a share, they have jumped to almost \$15. Santa Fe rejected

Union Pacific's offer and formally requested ICC approval to merge with BN. Investors also punished Illinois Central after it announced a July deal worth \$686 million to buy the railroad business of Kansas City Southern. Illinois Central's stock has fallen 16%, to around \$30, and Kansas City Southern's



has declined 16%, to \$36.

Concern over mergers is not the only thing pushing rail stocks down. Since the Federal Reserve started nudging interest rates higher in February, investors have been getting out of cyclical stocks like chemicals, steel, paper—and railroads. The two effects

have depressed the Standard & Poor's Railroad Index by 13% since Jan. 1.

The irony is that the railroad business has never been better. After painful downsizing in the 1980s that reduced capacity, cut workforces by 60%, and slashed costs, U.S. railroads are now steaming.

Traffic is up, especially high-margin intermodal shipping, where truck trailers containing consumer goods are stacked on rail cars and moved across the country, then off-loaded onto short-haul trucks.

Heading into a bumper harvest for U.S. corn and soybeans, railroads should have their best third and fourth quarters of all time, predicts Smith Barney Shearson's rail analyst James Valentine. Business is so strong, some lines are running up against capacity limits. That's allowing them to raise prices.

A conservative approach for investors is to pick rail lines that can boost earnings by further cost-cutting. Valentine puts Burlington Northern and CSX in that category. Both were distracted by divestitures in the late 1980s

and are now making up lost time. BN is central in its administration in Worth, a move that should save more than \$200 million. It has also launched an injury prevention program to bring down safety costs, curbing the industry's highest expense.

1992, CSX formed performance-improvement teams

ferret out savings. By year-end, the railroad is expected to have slashed \$385 million in costs compared with 1991.

GOOD BET. NatWest's Lloyd recommends buying smaller railroads as future takeover plays. These include Illinois Central and Kansas City Southern, which even after a merger will only be a billion railroad. Years of cutting at IC have yielded the lowest cost structure among the nation's 12 largest railroads. That's important because both IC and Kansas City Southern compete against low-cost barges on the Mississippi River.

PaineWebber's Hatch says Conrail, the once state-owned line that was privatized in 1987. Conrail, big in consumer-goods shipping, recently turned down a takeover from Norfolk Southern. Conrail is the largest carrier of autos from Detroit and developed a strong intermodal business, picking up goods in Chicago and shipping them east.

Santa Fe is still a good bet, Hatch says, despite its price run. The merger with BN would create the largest U.S. railroad, run from Winnipeg to Paso and combining Santa Fe's strength in intermodal transport and in coal and grain.

An economic downturn within 12 months could take steam out of any rally in rail stocks, with the fundaments chugging along. Stocks at bargain prices it may be time to go aboard. Susan Cha

Climbing Aboard the Railroads

COMPANY	P/E RATIO*	EST. 1994 EPS GROWTH	DESCRIPTION
BURLINGTON NORTHERN	12	28%	Longest U.S. railroad, largest transporter of grain and coal
CONRAIL	13	16%	Largest carrier in Northeast; biggest shipper of autos from Detroit
CSX	12	28%	Extensive rail network in East, Midwest, South; owns largest U.S. container shipper
ILLINOIS CENTRAL	12	16%	Only north-south route between Chicago and Gulf of Mexico; lowest cost structure
KANSAS CITY SOUTHERN	13	21%	Has spent \$500 million to improve rail facilities since 1990
SANTA FE PACIFIC	13	14%	Intermodal pioneer; runs high-speed routes between Chicago, West Coast, Mexico

*10/17/94 stock price, 1994 estimated earnings

DATA: BLOOMBERG FINANCIAL MARKETS

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In Touch with Tomorrow
TOSHIBA

A HYPERLINK FEAST: NEW CD-ROM ENCYCLOPEDIAS

Maybe, just maybe, your kids would pay more attention to their homework if, say, Captain Jean-Luc Picard of the Starship Enterprise were to help steer them. That's one of the hooks behind the 1995 edition of Compton's Interactive Encyclo-

CD-ROMS won't take as big a chunk out of your wallet either—assuming you already have a multimedia computer. Each disk will sell for about \$100 in stores. Grolier's 21 bound encyclopedia volumes, by contrast, command more than \$700.

By exploiting multimedia, the disks claim another advantage over the books:

The CD-ROMS are filled with video clips and sound. Instead of reading about the assassination of John F. Kennedy, a Compton's user can watch a brief narrated video of the events surrounding the November, 1963 weekend. A Gro-

lier video shows a flight made by Orville and Wilbur Wright. *Encarta* includes footage of a Venus's-flytrap disposing of prey. Students doing term papers can export pictures, maps, and text to their word processors, complete with citations. Articles also include bibliographies.

The CD-ROMS allow users to search for information quickly, and they can approach the task in a variety of ways. They can pull up articles by time period, general topic area, or by typing in a key word, such as "Eisenhower" or "Bosnia." By clicking on highlighted words, folks can jump to another topic—no longer do you have to lift Volume 16 off the bookshelf after leafing through Volume 11.

Compton's provides particularly strong searching capabilities and I pre-

ferred its clear interface. Students can type in key words or phrases, such as "all men are created equal" and "why is the sky blue," to access the relevant content. In one new feature called Editing Room, kids can meld together a series of articles, pictures, videos, and maps to create a show-and-tell multimedia presentation on, say, elephants. The presentation can be copied onto a floppy disk.

Encarta has improved its searching capabilities with friendly new menus to find ar-



GRO
MULTIMEDIA: Co
wisdom from celeb

graphic locations, subject time. For example, you narrow references on n down to, say, 19th-century Russia. Among the search results: an orchestral fragment from Tchaikovsky's *1812 Overture*. One minor quibble: I frequently use the Pinpointer box to see the real hidden underneath. **PAIN OF DEFEAT.** *Gr* also provides detailed searching capabilities, though jumping from one topic to another is as easy as with other programs. *Gr* does offer an appealing new feature called *makers*, in which celebrities speak about th

KNOWLEDGE ON A DISK

TITLE/ COMMENTS	ESTIMATED STREET PRICE
COMPTON'S INTERACTIVE ENCYCLOPEDIA Easy search tools; lets students concoct multimedia presentations	\$100
MICROSOFT ENCARTA '95 Music excerpts from full symphony orchestras and other fine multimedia touches	\$100
1995 GROLIER MULTIMEDIA ENCYCLOPEDIA Astronaut Buzz Aldrin and others discuss their craft in the Pathmakers feature	\$100

DATA: BUSINESS WEEK

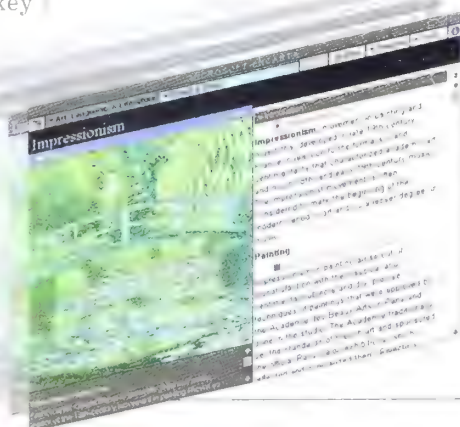
cles by interest area. In the InterActivities section you can sample musical instruments and foreign languages or hear stories from immigrants who came to Ellis Island.

The program's Pinpointer tool allows users to filter searches based on words, geo-

fluences on their careers. Olympic athlete Jackie Joyner-Kersey reflects on learning from defeat, while author Kurt Vonnegut Jr. talks about the writing craft.

The CD-ROM universe is already flooded with specialized reference works ranging from the *McGraw-Hill Multimedia Encyclopedia of Science & Technology* (published

MICROSOFT ENCARTA:
Voices from Ellis Island



pedia on CD-ROM: Picard's alter ego, actor Patrick Stewart, leads a video tour of the disk, minus *Star Trek* garb.

NEW GROUND. Compton's earthly rivals in the multimedia reference frontier, Microsoft and Grolier Electronic Publishing, are also charting new ground. *Microsoft Encarta '95* and the *1995 Grolier Multimedia Encyclopedia* are packed with revised content. Since last year's edition, for example, Microsoft has revised 38% of *Encarta's* articles and added references to events as recent as the Irish Republican Army cease-fire.

The disks are a boon for parents who want their children to have a multivolume encyclopedia but can't spare the space. A single platter can hold the entire 26 volumes of *Compton's Encyclopedia*. The

COMPTON'S:
Particularly strong
searching capabilities

SOFTWARE

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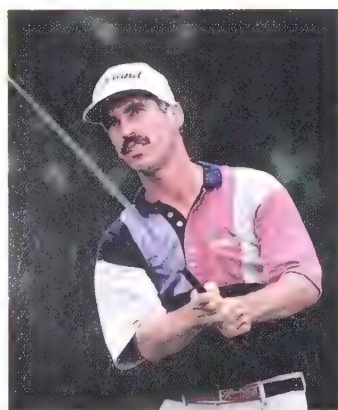
In Fortune. The top player will drive home this 1995 Eagle Vision TSi with \$2,000 in cash. The top 15 finishers win \$10,000 in cash and valuable prizes.

In Fame. Top players will be featured in Business Week magazine. Your name listed with the leaders in 6 of the 6 weekly issues starting 2/94.

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The PGA TOUR has enjoyed the most successful season in its history, and now the top players on the TOUR will gather October 24-30 at The Olympic Club in San Francisco for the grand finale – THE TOUR Championship.

It all comes down to this: the top 30 TOUR players on the money list in a battle for season-ending honors.

Nick Price and Greg Norman have been in a year-long fight for the Arnold Palmer Award, which goes to the TOUR's leading money-winner; but some other players can challenge the leaders by claiming the \$540,000 first prize money in the \$3 million event.

Norman, winner of this year's PLAYERS Championship in record-setting fashion, appears to have a firm grasp on the Vardon Trophy, which goes to the player with the

IT ALL COMES DOWN TO THIS

lowest stroke average for the year. But Freddie Couples and Price are hot on his heels and, as this year has proved, anything's possible.

"Anything's Possible" is the appropriate motto of the PGA TOUR, which will donate nearly \$30 million to charities this year through its three tours. Charity continues to be the biggest winner on TOUR. Last year's TOUR Championship raised more than \$450,000 for charity, with 49 Bay Area charities sharing in the proceeds of the event. Tournament organizers hope to give even more back to the area's communities this year.

To see the world's greatest players compete in this prestigious event – and make a significant contribution to charity in the process – **call 415-587-7888.**

A few season badges remain for \$120 for the week, and a limited number of daily tickets can be purchased for \$20 each for practice rounds and \$35 each for championship play.

If you can't make it to San Francisco, it's not too early to make plans for the 1995 TOUR Championship, which will be played at Southern Hills Country Club in Tulsa, Oklahoma. For more information, call 904 285-7888.

The 1994 TOUR Championship is presented by these sponsors:



Mercedes Benz



All four rounds of this year's TOUR Championship will be televised by ESPN and ABC Sports. The complete schedule:



Thursday, Oct. 27, 4-6 p.m., EST – ESPN
Friday, Oct. 28, 5-7 p.m., EST – ESPN

Saturday, Oct. 29, 4-7 p.m., EST – ESPN
Sunday, Oct. 30, 3-6 p.m., EST – ABC



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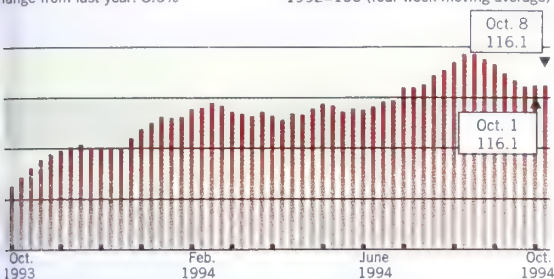
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Business Week Index

PRODUCTION INDEX

Change from last week: 0%
Change from last year: 8.5%

1992=100 (four-week moving average)



Production index was flat in the week ended Oct. 8. Gains in seasonally adjusted output of steel, autos, trucks, and electric power offset production drops in oil refining, coal, paperboard, paper, lumber, and rail-freight traffic. Before revision of the four-week moving average, the index fell to 115.2, from 116.8. The index has been updated to reflect 1992 weightings of its components and is now based on 1992. Weekly and monthly history is available from BUSINESS WEEK.

BW production index copyright 1994 by McGraw-Hill Inc.

LEADING INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
LESS WEEK LEADING INDEX* (10/8)	246.40	246.20r	8.2
STOCK PRICES (10/14) S&P 500	465.43	456.98	0.4
SHORT-TERM RATE BOND YIELD, Aaa (10/14)	8.50%	8.57%	28.4
INDUSTRIAL MATERIALS PRICES (10/14)	107.3	108.2	13.8
NEW BUSINESS FAILURES (10/7)	296	293	-14.2
REAL ESTATE LOANS (10/5) billions	\$443.3	\$440.2r	6.4
VEHICLE SUPPLY, M2 (10/3) billions	\$3,559.6	\$3,562.3r	1.6
NEW CLAIMS, UNEMPLOYMENT (10/1) thous.	319	310	-0.6

*Source: Center for International Business Cycle Research (CIBCR), Standard & Poor's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of companies), Federal Reserve, Labor Dept. CIBCR seasonally adjusts data on new business failures and real estate loans. *Copyright 1994 by CIBCR.

INTEREST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
LIBOR (10/18)	4.71%	4.71%	2.97%
COMMERCIAL PAPER (10/18) 3-month	5.44	5.53	3.24
SAVINGS DEPOSITS (10/19) 3-month	5.45	5.52	3.23
MORTGAGE (10/14) 30 year	9.08	9.03	6.83
TABLE MORTGAGE (10/14) one year	5.98	5.80	4.15

Source: Federal Reserve, HSH Associates

Data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment. 1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

EMPLOYMENT COST INDEX

Oct. 25, 8:30 a.m. ▶ Employers' compensation costs, including wages and benefits, are expected to have risen 0.8% in October, according to the forecast of economists surveyed by the Conference Board. Employment costs would be up annually, a bit less than their 3.7% year ago.

CONSUMER CONFIDENCE

Oct. 25, 10 a.m. ▶ The Conference Board's index of consumer confidence edged higher in October, to 89, up from 84 in September, says the survey. It had slipped for three months in a

row. Higher interest rates may be partly to blame for consumers' loss of faith, but confidence remains at a level that is consistent with a healthy economy.

DURABLE GOODS ORDERS

Wednesday, Oct. 26, 8:30 a.m. ▶ Manufacturers' new orders for durable goods are expected to have risen by 0.5% in September, say the MMS economists. That would follow the 6.1% surge in August, fueled by increased output, and thus orders, for cars and trucks. Strikes and parts shortages in the auto industry, however, will depress September bookings. Orders excluding the volatile transportation sector should give a truer reading of demand.

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (10/15) thous. of net tons	1,908	1,929#	1.8
AUTOS (10/15) units	132,329	134,318r	2.2
TRUCKS (10/15) units	112,122	116,239r	0.7
ELECTRIC POWER (10/15) millions of kilowatt-hrs.	54,830	57,232#	0.8
CRUDE-OIL REFINING (10/15) thous. of bbl./day	13,605	13,762#	-2.3
COAL (10/8) thous. of net tons	18,651#	20,514	-0.8
PAPERBOARD (10/8) thous. of tons	846.7#	898.0r	3.9
PAPER (10/8) thous. of tons	811.0#	833.0r	-1.0
LUMBER (10/8) millions of ft.	481.3#	496.8	0.4
RAIL FREIGHT (10/8) billions of ton-miles	24.5#	24.9	4.7

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., American Forest & Paper Association, WWPAA¹, SFPAA², Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (10/19) \$/troy oz.	391.100	387.900	5.0
STEEL SCRAP (10/18) #1 heavy, \$/ton	133.50	133.50	1.5
COPPER (10/15) ¢/lb.	120.7	121.5	40.9
ALUMINUM (10/15) ¢/lb.	81.3	80.0	57.1
COTTON (10/15) strict low middling 1-1/16 in., ¢/lb.	67.14	66.26	22.3
OIL (10/18) \$/bbl.	17.39	17.71	-4.2

Sources: London Wednesday final setting, Chicago market, Metals Week, Memphis market, NYMEX

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (10/19)	97.15	99.95	108.37
GERMAN MARK (10/19)	1.50	1.54	1.67
BRITISH POUND (10/19)	1.62	1.58	1.48
FRENCH FRANC (10/19)	5.15	5.28	5.84
ITALIAN LIRA (10/19)	1532.0	1568.0	1609.0
CANADIAN DOLLAR (10/19)	1.36	1.35	1.31
MEXICAN PESO (10/19) ³	3.420	3.419	3.108

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars

GROSS DOMESTIC PRODUCT

Friday, Oct. 28, 8:30 a.m. ▶ Real gross domestic product probably grew at a 2.5% annual rate in the third quarter. That pace would be much slower than the second quarter's 4.1% and the first quarter's 3.3%. A slower pace of inventory building, following the second quarter's sharp acceleration, should provide the biggest drag. Housing, business construction, and net exports should also be negatives. On the plus side, consumer spending is expected to pick up from its second-quarter pace, while business investment in equipment will continue to provide a big lift. The fixed-weight price deflator is expected to rise 3%, compared with 2.9% in the second quarter.

Whaddya Say To
A Guy Who's Had
The Same Job
For 50 Years,
Has Never Called
In Sick Or
Showed Up Late,
Never Taken A
Vacation Or A
Holiday, Never
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Raise Or Griped
About His Bonus
And, Believe It Or
Not, Has No
Plans For
Retirement?



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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

ABB 64, 68
Advantage Indoor Advertising 8
A.G. Edwards 130
Air France 59
Alanex 122
All American Gourmet 54
American Airlines 114
American Cyanamid 122
American Express 68
American Home Products 6, 122
American Superconductor 127
Amgen 122
Ampad 45
Anaheim Mighty Ducks 84
Apple Computer 24, 54, 117
Archer Daniels Midland 68
Arris Pharmaceutical 122
Arthur Andersen 86
Artisoft 24
AT&T 54

B

Bally Entertainment 98
Banc One 50
Bankers Life & Casualty 46
Bankers Trust 86, 92
Bank Julius Baer 60
Bank of America 77
Barclays de Zoete Wedd 59
Baring Securities (Japan) 108
BASF 98
Bear Stearns 40, 118
Bechtel 98
Bell Atlantic 52
Beverly Enterprises 106
Blockbuster Entertainment 84
Boston Bruins 84
Bristol-Myers 122
British Airways 59
British Midland Airways 59
Brown Brothers Harriman 92
Burlington Northern 132
Business Express 44

C

Caltex 64
Canada Northwest Energy 8
Canon 117
Capital Market Risk Advisors 86, 100
Case 48
Caterpillar 48
CCP Insurance 46
Charles Schwab 130
Chicago Cubs 10
Ciba-Geigy 98
Citicorp 64, 86
Cleo 86
Cleveland Indians 10
Coca-Cola 54, 98
Colgate-Palmolive 9
Community Psychiatric Centers 106
Compaq Computer 24, 117

Conner Peripherals 42
Conrail 132
Conseco 46
Continental Airlines 114
Coopers & Lybrand 86, 96
Cray Research 116A
CS First Boston 108
CSX 132

D

Daiwa Securities America 33
Days Inns 65
Deere 48
Dell Computer 86
Delta Hotels & Resorts 8
Detroit Red Wings 84
Deutsche Bank 98, 102
Dr Pepper/Seven-Up 54
DRI/McGraw-Hill 33

E

Eastman Kodak 52, 54
EDS 50
Emcor 86, 100
ENI 68
Enron 64, 86
Euro Disneyland 59
Eurotunnel 59

F

Federal Express 64, 65
Fidelity Investments 10, 130
First Data Resources 50
FMC 86, 98
Ford 98
Fox Broadcasting 84
France Telecom 50
Fujitsu 117

G

Gap 6
GE 40, 46
Gemini Consulting 130
Genentech 122
General Instrument 6
General Nickel 8
Genesis Merchant 106
Genetics Institute 122
Geotek 118
Gibson Greetings 86, 142
Glaxo 122
GM 10, 54
Goeken Custom Communications 10
Goldman Sachs 40, 60, 102
Grolier Electronic Publishing 134
GTE 54

H

H&R Block 50
Hartford Whalers 84
H.B. Fuller 64
Heinz 54
Hewitt Associates 33
Hewlett-Packard 24
Huntington Bancshares 50

I

I/B/E/S 42
IBM 6, 24, 54, 72, 117
ICOS 122
Illinois Central 132
Implemed 127
Intel 24, 64, 86, 98

Interactive Transaction Partners 50
Internet Patent News Service 127
Intuit 50
ITT 84, 112

J

Johnson & Johnson 122
J.P. Morgan 86, 98, 100

K

Kansas City Southern 132
Kawasaki Steel 54
Kemper 46
Kidder Peabody 40, 86, 89
Kirin Brewery 122
KPMG Peat Marwick 50

L

Lehman Brothers 118, 122
Levi Strauss 6
Lexmark 98
Lipper Analytical Securities 40

M

MacDonald Mines 8
Major League Baseball 84
Maple Leaf Gardens 84
Matsushita 108, 112
MCA 108, 112
McDonald's 98
McGraw-Hill 134, 139
MCI 54
McKinsey 122
M.D. Sass Investors Services 46
Merck 86, 88, 98
Meridian Bancorp 50
Merrill Lynch 89, 102, 117, 122, 130
Metallgesellschaft 98, 142
Micron Technology 54
Microsoft 24, 50, 117, 134
Mitsui 117
MMS International 139
Mobil 98
Moody's Investors Service 46
Morgan Stanley 40, 86
Motorola 10, 72, 117
Multinational Computer Models 98

N

National Payment Clearinghouse 50
NatWest Securities 114, 132
NBC 112
NEC 58, 117
New England Consulting 8
New York Rangers 84
Nextel 118
NHL 84
Nomura Research 42
Norfolk Southern 132
Northwest Airlines 114
Nynex 64

O

Oak Ridge Investments 130
Olsen & Associates 98
Oppenheimer 40

P

Pacific Semiconductors 64
PaineWebber 40, 132
Perkin-Elmer 86
Philippine Asia Equity Securities 64

Phillips Long Dist Telephone 64
Philips Electronics
Piper Jaffray 86, 14
Procter & Gamble 65, 86, 98, 142
Prudential Insurance 96

Q

QMS 24

R

Regeneron Pharmaceuticals 1
Reliance Electric 1
RFM 64
Ricoch 72
Roche 54

S

Salomon Brothers 3
Santa Fe Pacific 13
Sears 6
Sharp 108
Sherritt 8
Smith Barney Shearson 6, 108
Solon Asset Management 100
Sony 108
Southwest Airlines
Sun Life Assurance Society 10
Sunset Cliffs Merchandising 8
Swiss Bank 86
Symantec 24
Syntex 54

T

Tektronix 24
Tel/Logic 10
Texas Rangers 45
3DO 108, 112
3M 98
Timex 65
Toshiba 58, 117
Toyota 58
T. Rowe Price 46

U

Uniden America 6
Union Carbide 98
Union Pacific 132
United Airlines 11
Universal Pictures
Universal Studios
USAir 114
U S West 50

V

ValuJet 114
Vanguard Cellular Systems 118
Victor 108
Virgin Records 112
Visa 50

W

Wainwright Industries
Walt Disney 84, 11
Wells Fargo 77
Westinghouse Hanford 127
WMX Technologies 98
Wyeth Philippines

X

Xerox 72

Y

Yankee Group 118

Z

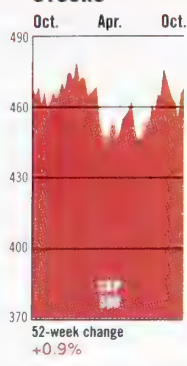
Zenith Electronics
Zeos International
Zymogenetics 122

Investment Figures of the Week

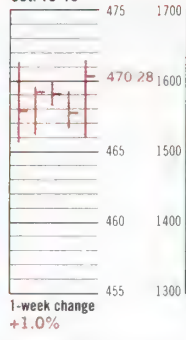
STOCKS

continued their recent advance as third-quarter earnings came in a lot stronger than expected. Huge profit gains at such companies as Motorola, Philip Morris and Citibank sent the large-cap averages soaring. For the week, the S&P 500 index climbed 0.9%, a stock advance was even more impressive because it wasn't helped by a rally in bonds, which just held their own for the week. They may continue their run. Three technical indicators on this page are pointing up.

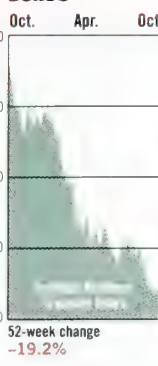
STOCKS



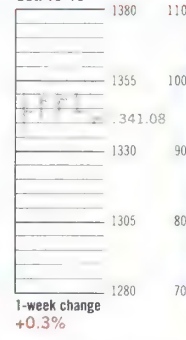
BONDS



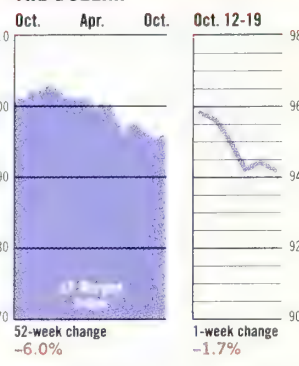
BONDS



THE DOLLAR



THE DOLLAR



MARKET ANALYSIS

STOCKS

	Latest	% change Week	% change 52-week
INDUSTRIALS	3936.0	1.6	8.0
COMPANIES (S&P MidCap Index)	175.7	0.4	1.2
COMPANIES (Russell 2000)	254.8	0.0	-0.1
COMPANIES (Russell 3000)	269.9	0.8	0.3
	Latest	% change Week	% change 52-week
FINANCIAL TIMES 100	3060.8	-1.3	-3.0
NIKKEI INDEX	19,868.9	-1.1	-1.5
TSE COMPOSITE	4320.8	-0.8	3.3

FUNDAMENTALS

	Latest	Week Ago	Year ago
90-DAY TREASURY BILL YIELD	5.02%	5.12%	3.12%
30-YEAR TREASURY BOND YIELD	7.89%	7.89%	5.82%
S&P 500 DIVIDEND YIELD	2.75%	2.75%	2.73%
S&P 500 PRICE/EARNINGS RATIO	18.3	18.3	21.9

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 200-day moving average	460.6	460.6	Positive
Stocks above 200-day moving average	38.0%	36.0%	Positive
Speculative sentiment: Put/call ratio	0.68	0.72	Neutral
Insider sentiment: Vickers sell/buy ratio	1.39	1.37	Positive

BLOOMBERG FINANCIAL MARKETS

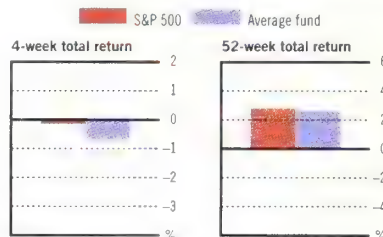
INDUSTRY GROUPS

	% change 4-week	% change 52-week	Strongest stock in group	% change 4-week	% change 52-week	Price
OIL & GAS DRILLING	5.9	-16.8	HELMERICH & PAYNE	12.8	-7.9	30 3/4
PAPER COMPANIES	5.6	-24.9	NIAGARA MOHAWK POWER	11.5	-43.1	13 3/8
HOUSEHOLD PRODUCTS	5.5	12.6	COLGATE-PALMOLIVE	8.5	3.2	60 7/8
BEVERAGES	5.4	4.6	COCA-COLA	6.5	15.6	50 7/8
DRUGS	4.8	9.9	PFIZER	10.8	17.1	72
	% change 4-week	% change 52-week	Weakest stock in group	% change 4-week	% change 52-week	Price
TELECOMMUNICATIONS	-15.2	-43.7	PULTE	-18.3	-45.3	21 1/4
HAIR CARE	-11.9	-20.1	TJX	-25.4	-47.7	16 7/8
FACTORY MANUFACTURING	-9.2	3.0	FLEETWOOD ENTERPRISES	-11.3	-1.1	22 5/8
BANKS AND LOANS	-8.8	-3.4	H.F. AHMANSON	-11.3	2.0	19 5/8
MINING AND CONSTRUCTION	-8.3	7.4	FLUOR	-9.0	20.1	47

MORNINGSTAR INC.

MUTUAL FUNDS

	%	LAGGARDS	%
4-week total return		4-week total return	
WELLS FUND-NORDIC NATL. FID. EQTY.	4.2	UNITED SERVICES CHINA REGION OPPORT.	-4.4
WELLS FUND-RUSHMORE UTILITY INCOME	3.8	ALLIANCE PREMIER GROWTH A	-4.1
WELLS FUND-UTILITIES B	3.2	AMERICAN HERITAGE	-3.6
52-week total return		52-week total return	
WELLS FUND-LATIN AMERICAN EQUITY	44.7	AMERICAN HERITAGE	-30.8
WELLS FUND-STANLEY ASIAN GROWTH A	25.7	BULL & BEAR SPECIAL EQUITIES	-22.5
WELLS FUND-EMERGING MARKETS	24.0	DREYFUS SPECIAL GROWTH INVESTOR	-20.7



DRUMMcGRAW-HILL

FIVE PORTFOLIOS

Points represent the value of \$10,000 one year ago

Points indicate total returns

Foreign stocks
\$11,741
+3.73%

Gold
\$10,407
+0.54%

U.S. stocks
\$10,245
+0.40%

Money market fund
\$10,208
+0.06%

Treasury bonds
\$8,747
+0.20%

Figures on this page are as of market close Wednesday, Oct. 19, 1994, unless otherwise indicated. Industry groups include S&P 500 companies only; performance and share prices are

as of market close Oct. 18. Mutual fund returns are as of Oct. 14. Relative portfolios are valued as of Oct. 18. A more detailed explanation of this page is available on request. r=revised

IN AMERICA, IQ IS NOT DESTINY

Two things are absolutely true about *The Bell Curve*, the hot new book about IQ and achievement by Charles Murray and the late Richard J. Herrnstein. First, there is nothing new in the message. In the 1960s, physicist William B. Shockley advocated sterilization of people with low IQs, and psychologist Arthur S. Jensen scorned Head Start as useless because black kids were said to have inherited low IQs. Second, the importance of the book lies in its social context. America has a long history of turning to Darwinism and genetic explanations for inequality during times of economic dislocation. The 1990s certainly qualify.

So does the post-Civil War era, when capital and wealth were growing and recessions racked the middle and working classes. At that time of robber barons, political scientist William Graham Sumner was teaching at Yale University that "millionaires are a product of natural selection." The argument, of course, was that any kind of social or political change to increase fairness, opportunity, or equality for most people was hopeless. The implication is clear: Nature does the sorting, and attempts at change are naive.

The 1920s and '30s—both decades of economic stress—saw a resurgence of genetic rationalization of inequality. The pseudoscience of eugenics, which started with British comparisons of brain size and intelligence in the 19th century, was first used as a justification for colonizing Africa. Blacks (and, indeed, women) were said to have smaller brains—ergo, less intelligence. Packaged as modern science before World War II, eugenics led to enforced sterilizations in the U.S. and all kinds of horrors in Germany.

Now come Murray and Herrnstein, purporting to break a putative taboo against speaking about IQ and race—a subject that has, in fact, been debated for over a century. Wrapped in

an impenetrable fog of statistics, they argue that if intelligence is inherited and IQ is critical to success, efforts to improve people's opportunities in life are a waste of taxpayers' money—nothing because nothing can be done.

All this sounds like an attack on the tax-and-spend government liberals. And that it surely is. But it should be clearly understood that Murray's real dispute is with the American conservative tradition of equality of opportunity, not simply with equality of outcome. The true targets of *Bell Curve* are Jack F. Kemp, William J. Bennett, and Ronald Reagan. The heart of their conservative philosophy is to create a society of opportunity by replacing irrational incentives generated by bad government programs with market-based incentives. This would free all people to take the best shot.

But following Murray's logic, school vouchers and similar choice are stupid policy options because letting parents pick kids from bad schools to good ones won't improve their IQs baked in. Tax breaks and enterprise zones to promote urban business are pointless: High-IQ people will do well anyway, and low-IQ folks will fail even with help. Workfare for the poor is fated to fail because persons with low IQs don't benefit from work experience. Immigration is bad because it brings in people with low IQs, the same people who are said to compete unfairly against American workers in trade.

Biological determinism, which is what the Murray-Herrnstein book is all about, is anathema to the opportunity society. It opposes all market-based public-policy reform. Success matters in achievement, but no more so than ambition, activity, education, family, hard work, or character. The ultimate betrayal of the American ideal would be abandoning belief in the power of equality of opportunity.

MAKING RISK LESS RISKY

One of the paradoxes of recent years is that the financial instrument generating greatest risk—the derivative—is also the best one for managing that risk (page 86). Want to hedge against currency swings? Interest rate moves? Commodity price fluctuations? In each case, options, futures, and swaps are all vital tools. Derivatives are the common denominator in all risk-management strategies.

Risk is good. It offers a promise of higher returns. Indeed, risk-taking and risk-control are interdependent activities aimed at raising rates of return. For example, 19th-century America was an exceptional era for entrepreneurs, capitalist buccaneers, and empire builders. But those high-risk boom times were built on an economic organization that controlled risk: the limited-liability corporation, which lets entrepreneurs seize opportunity without risking their personal wealth.

Today, derivatives can be the way to limit risk. Yet as true becomes a vice if taken to excess. Just ask direct Procter & Gamble, Piper Jaffray, Gibson Greetings, or allgesellschaft, all of which took multimillion-dollar hits from complex derivative plays. For that reason, companies should disclose all their derivative strategies and risk-management tactics. Regulators, in turn, should press mutual funds to step up the flow of information on derivatives.

Dangers will remain, and exotic financial instruments multiply the threat of a global financial meltdown. Bank regulators around the world need to learn the latest risk-management techniques to prevent a collapse in the capital markets. Better risk management will let the animal spirits of capitalism flourish and will cut down on the odds of a global meltdown when the inevitable excesses occur.



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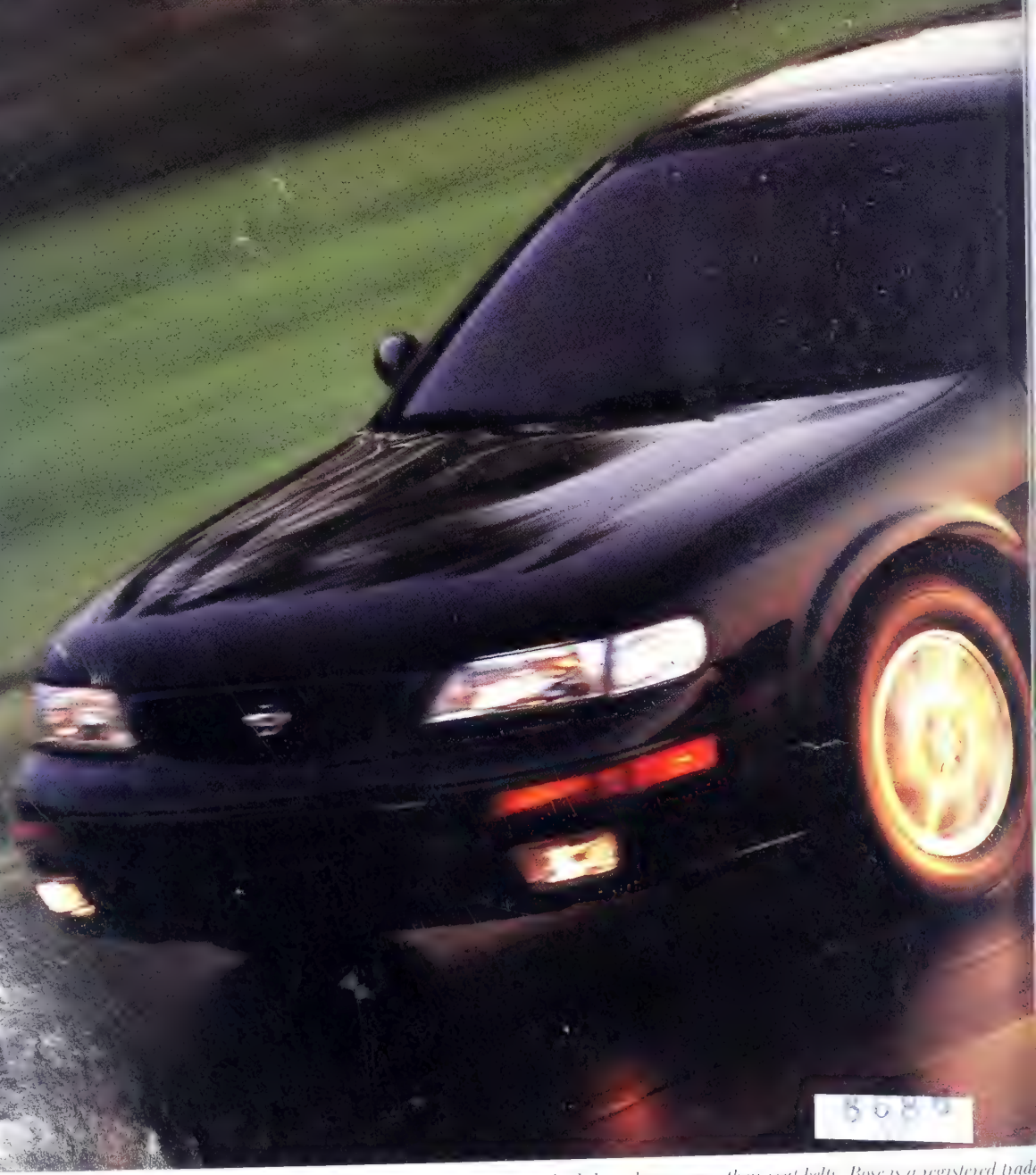
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